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NABE Outlook

NABE MACROECONOMIC FORECAST RESULTS

September 1989

This report presents the consensus of macroeconomic forecasts made by a panel of professional forecasters drawn from the membership of the National Association of Business Economists. Most of the forecasts submitted were made in August and are being reported in September 1989. This survey is one of three taken regularly by NABE; the other inquiries are the Industry Outlook and the Economic Policy Surveys.

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Highlights

* The longest peace-time expansion in U.S. history is expected to continue through the remainder of 1989, according to the vast majority of NABE's panel of forecasting experts. Over 90% of the panel of 72 professional business economists foresee continued growth into 1990. The panel's median forecast is for a 2.1 percent 4th quarter-to-4th quarter increase in 1989. While this is much lower than the 3.4 percent growth rate in 1988, it is well in line with the trend growth in the economy's productive capacity and is only a bit lower than the 2.3 percent increase forecast in last quarter's survey.

* A substantial majority of the panel expect growth to continue at about the same rate throughout 1990, with a median forecast of 2.2 percent on a 4th quarter-to-4th quarter basis. This is essentially unchanged from the previous forecast. Growth at this rate for the next 1 1/2 years would constitute the much-sought-after "soft landing", a transition from the rapid growth of 1988 to a more sustainable rate in the 2 1/2 percent range.

* With the oil and food price increases having worked their way through the economy without any lasting impact, the panel has scaled back its inflation forecasts for this year -- the median 4th quarter-to-4th quarter change in Consumer Prices is now 5.0 percent, down from 5.3 percent in the last forecast. This does represent an increase over the 1988 inflation rate of 4.3 percent, but the increase is almost entirely explained by the oil and food shocks in the first half of 1989. The median forecast for 1990 CPI inflation is for 4.3 percent (again on a 4th quarter-to-4th quarter basis). This is not only slower than the expected 1989 pace but is identical with 1988's rate. In other words, the core rate of inflation remains in the 4-4.5 percent range.

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* A majority of our panelists have now moved the expected arrival of the next recession out to 1991 or beyond. Only 37% now expect a recession to arrive this year or next, while a significant 31% do not see a business downturn before 1992.

* Panel members expect to see some continued improvement in the trade deficit this year, with a median forecast of a $110 billion deficit, versus a $122.8 billion red ink figure in 1988. The budget deficit also shrinks somewhat -- the panel now expects a $150 billion deficit, somewhat smaller than the $155.1 billion recorded last year. Both deficits are expected to continue to improve in 1990, with the trade figure falling further, to $100 billion, and the budget deficit shrinking to $135 billion. However, this latter figure is still nowhere near the $100 billion Gramm-Rudman-Hollings deficit reduction ceiling mandated for fiscal 1990.

* Interest rates have finally settled down and allowed the panelists' forecast to catch up. The median forecast of 7.9 percent for three month Treasury bills for September is well in line with current rates, as is the 8.1 percent forecast for 30 year bonds. Short rates are expected to continue to decline through 1989 and most of 1990, ending the year at 7.3 percent. Long term Treasury bond yields are expected to remain flat, in the 7.9-8.1 percent range throughout the period. Thus, the yield curve, which has been flat to inverted since last November, is expected to resume a more normal profile, with short rates lower than long.

The "Soft Landing" Expected to Continue

At the time of this writing, the Fed seems to have engineered the much-awaited "soft landing". Economic growth has dropped to below 3 percent, inflation is dropping, and interest rates are easing. A majority of NABE's panel members expect this soft landing to continue through 1990, with real growth at a level fast enough to keep the unemployment rate below 6 percent, but slow enough to keep inflation in the 4 - 4 1/2 percent range.

However, the panelists' responses do imply a slowdown in economic growth in the last half of this year. Most panelists prepared their forecasts based on the preliminary estimate of 1.7% real GNP growth in the 2nd quarter of 1989. Using this figure, their implied growth for the last half of the year is 1.5%. Since most of the forecasts were prepared, the 2nd quarter growth figure has been revised upwards to a 2.7% rate. Those panelists who incorporated the revised data in their forecasts had a median growth (4th quarter-to-4th quarter) of 2.7%, with an implied growth rate of 2.2% for the last half of this year. Either set of figures is consistent with a "soft landing" scenario.

Inflation Forecasted to Ease in 1990

The panel members' median forecast has inflation beginning to decline in the last quarter of 1989, with a further drop next year. The 4th quarter-to 4th quarter change in the Consumer Price Index for 1989 is projected at 5.0 percent, up from a 4.3 percent rate in 1988. The major causes of the increase are the higher oil and food prices encountered earlier in the year. On a year-over-year basis, the CPI is expected to rise an identical 5.0 percent. As in previous forecasts, the GNP Implicit Price Deflator shows a somewhat lower inflation rate of 4.4 percent for 1989 year-over-year.

The good news in the inflation story is that the food and oil shocks had no effect on the "core rate" of inflation, which is felt to be in the 4 - 4 1/2 percent range. Thus, the panel members have the 1990 CPI inflation rate at 4.5 percent (year-over-year), with the GNP Deflator running at a 4.2 percent rate.

The Forecast Spread Stabilizes for 1989 and Narrows for 1990

There was little change in the spread in the 1989 forecasts between the optimistic and pessimistic panel members, as can be seen from the table below:

Real GNP Growth (1988Q4-1989Q4)	Aug 88	Nov 88	Estimates of Survey in: Feb 89	May 89	Sep 89
Median Forecast	2.0%	2.2%	2.5%	2.3%	2.1%
Upper Quartile (25%)	3.0	3.2	3.4	3.0	2.9
Lower Quartile (25%)	0.6	1.1	1.4	1.5	1.5
Spread (Upper - Lower)	2.4	2.1	2.0	1.5	1.4

However, the 1990 spread narrowed perceptibly, a reflection of the adoption of a "soft landing" scenario by the majority of the survey respondents:

Real GNP Growth (1989Q4-1990Q4)	Estimates of Survey in: May 89	Sep 89
Median Forecast	2.3%	2.2%
Upper Quartile (25%)	3.4	3.0
Lower Quartile (25%)	0.7	1.2
Spread (Upper - Lower)	2.7	1.8

It is interesting to note that the 1.8 percentage point spread of the current forecast is much tighter than the 2.4 point spread in the 1989 forecast at the same time last year. It seems that the majority of our panel members are more comfortable with the "soft landing" scenario than they were at this time last year.

Sector Outlook Unchanged from Last Forecast

Given that there was little change in the overall economic growth forecast, it should come as no surprise that the sectoral outlook is relatively unchanged from May's forecast:

* Industrial production is now expected to grow at 3.1 percent, little changed from the 3.2 percent in May. The median forecast is for a slowdown to 1.7 percent (on a year-over-year basis) for 1990. As in last quarter's forecast, caution must be taken in interpreting these year-over-year forecasts. The economic slowdown in the median forecast is taking place in the last half of 1989 and thus does not show up in the year-over-year figures until 1990.

* Housing starts are now forecast to average 1.42 million units, effectively unchanged from the 1.41 million in the last forecast. As before, 1990 starts, at 1.45 million units, show little change from this year's expected levels.

* The median forecast for auto sales is 10.0 million units, up only a bit from the May projection of 9.9 million. The 1990 forecast is for 9.8 million units. Van and truck sales are expected to be 5.0 million units in 1989 and 4.9 million in 1990.

Quarterly Interest Rate Forecasts

Our panel provide us with a quarterly path for both short and long-term interest rates. The forecasts for the average interest rates for the last month in each quarter, along with the average of the upper and lower 25%, are shown below:

Table 1

Quarterly Interest Rate Projections

	Jun89A	Sep89F	Dec89F	Mar90F	Jun90F	Sep90F	Dec90F
3 Month T-Bills							
- median	8.2%	7.9%	7.6%	7.4%	7.2%	7.2%	7.3%
- upper 25%		8.1	8.2	8.2	8.3	8.2	8.3
- lower 25%		7.7	7.1	6.8	6.4	6.4	6.2
30 Yr. T-Bonds							
- median	8.3%	8.1%	8.0%	7.9%	7.9%	8.0%	8.0%
- upper 25%		8.3	8.5	8.5	8.5	8.6	8.8
- lower 25%		7.8	7.6	7.4	7.3	7.3	7.1

A = Actual; F = Forecast

A 1989-1990 Recession Not Thought Likely

Almost 2/3 of our panel members now think that a recession is not likely before 1991, reflecting the widespread support for a "soft landing" scenario. Almost 1/3 of our respondents think that another recession will not arrive until 1992 or later. If the expansion does continue until that time, it will set a record for the longest expansion (in either war or peacetime) in the history of the United States.

Table 2

Timing of the Next Recession

Next Recession Begins In:	% of Respondents in: May 88	Aug 88	Nov 88	Feb 89	May 89	Sep 89
1989	57.4%	47.3%	40.0%	19.2%	19.6%	11.9%
1990	31.5	41.8	48.3	55.8	43.5	25.4
1991	1.9	9.1	8.3	17.3	17.4	32.2
1992	3.8#	1.8#	1.7	1.9	6.5	13.6
1993 or later	-	-	1.7	5.8	13.0	16.9

= 1992 or later

Table 3

Summary of NABE Median Forecasts

	1988 Actual	1989 Forecasts Feb 89 Survey	1989 Forecasts May 89 Survey	1989 Forecasts Sep 89 Survey	1990 Forecasts May 89 Survey	1990 Forecasts Sep 89 Survey
Fourth Quarter to Fourth Quarter						
Real GNP	3.4%	2.5%	2.3%	2.1%	2.3%	2.2%
Consumer Price Index	4.3%	4.8%	5.3%	5.0%	4.7%	4.3%
Annual Averages						
Real GNP	4.4%	2.7%	2.8%	2.6%	1.8%	1.8%
Pers. consum. expend.	3.4%	2.5%	2.5%	2.2%	1.9%	1.9%
Nonres. fixed invest.	8.4%	4.0%	4.6%	3.6%	1.8%	2.7%
Net exports (BB 82$)	-$74.9	-$85	-$90	-$53	-$76	-$47
Nominal Magnitudes:						
Merch. trade bal.	-$122.8	-$103#	-$112	-$110	-$100	-$100
Fed. budg. def.(FY)	-$155.1	-$155	-$160	-$150	-$140	-$135
Corp. prof.(aft.-tax)	18.9%	6.3%	5.3%	2.5%	1.9%	2.0%
Real Magnitudes:						
Unempl. rate (civ.)	5.5%	5.5%	5.4%	5.3%	5.8%	5.7%
Indus. production	5.7%	3.4%	3.2%	3.1%	1.8%	1.7%
Housing starts (MM)	1.49	1.44	1.41	1.42	1.44	1.45
Tot. veh. sales (MM)	15.8	15.3	14.9	15.0	14.9	14.7
Autos	10.6	10.2	9.9	10.0	9.9	9.8
Domestic	7.5	7.3	7.1	7.1	7.1	7.0
Imports	3.1	2.9	2.8	2.9	2.8	2.8
Trucks	5.2	5.1	5.0	5.0	5.0	4.9
Inflation and Interest Rates:						
Consumer price index	4.1%	4.7%	5.1%	5.0%	4.8%	4.5%
GNP deflator	3.3%	4.5%	4.6%	4.4%	4.4%	4.2%
Treasury bills (3 mo.)	6.7%	8.0%	8.6%	8.1%	7.6%	7.3%
Treas. bonds (30 yr.)	9.0%	9.2%	9.1%	8.4%	8.8%	7.9%

\# Old forecast adjusted for new Customs definition.

The Sep 1989 columns are based on 72 responses received.

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Highlights

* A majority (62%) of the NABE panel expects no recession within the next three years. However, half of those expecting a recession see the current quarter and the first quarter of 1990 as the period of greatest vulnerability for the economy.

* Reflecting both the currently-weaker economy and a deteriorating outlook for the coming year, the median forecast for 1990 GNP has been lowered from 2.2% in September to 2.0% (both figures on a fourth-quarter-over-fourth-quarter basis).

* The expected composition of GNP in 1990 has also been altered. Consumer demand is expected to constitute a significantly larger share of growth while investment, reflecting a deteriorating outlook for corporate profits, is expected to be weaker. Forecasts of industrial production continue to weaken.

* The easing of inflation fears reflected in the September survey continues. On a fourth-quarter-over-fourth-quarter basis, the CPI in 1990 is now expected to increase by 4.2%, compared with a forecast of 4.3% in September and 4.7% in May.

* The slower overall growth and weaker industrial output is not expected to be reflected in higher unemployment. The forecast unemployment rate for 1990 is now 5.5%, compared with 5.7% in September.

* Interest rates, especially in the shorter maturities, are expected to continue their easing. By December of 1990, 3 Month T-bills are expected to be at 7.0% (compared with a forecast in September of 7.3%) and 30 year T-bonds are expected to be at 7.9% (compared with the earlier forecast of 8.0%).

* The forecasting approach used (Keynesian, monetarist, or "other") has little impact on the 1990 outlook.

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1990 Economic Outlook

The NABE consensus forecast for 1990 shows an economy that continues to expand, albeit slowly, with inflation rates and interest rates lower than in 1989. The main findings from the latest survey of forecasters are described below and are summarized in Table 1.

Expansion or Recession? A majority of the panel (62%) expects no recession in the next three years. This optimistic conclusion, however, is tempered by considerable concern about the very short-term outlook. Of the 38% who are expecting a recession in the next three years, half believe it will begin in either 1989Q4 or 1990Q1. Thus the weakness in many current indicators has caused almost one fifth of the panel to conclude a recession is at hand; no doubt, many of the rest who see expansion continuing also believe the period of greatest risk is in the next few quarters.

Real GNP and Components in 1990. The median forecast looks for moderate growth of real GNP in 1990. On the year average basis the gain is put at 1.8%, a significant deceleration from the 2.9% now expected for 1989. Measured over the period 1989Q4 - 1990Q4 growth is expected to be 2.0%, a projection that has been lowered from 2.3% in the May survey and 2.2% in the September inquiry; the pace is projected to be beneath the 2.5% of 1989, measured on the same basis. By major component, year average data are expected to show the following:

* Personal consumption expenditures are the mainstay, with a gain of 2.1%; although slower than the rise in 1989, the consumer advance exceeds that of GNP, so consumption gains share.

* Nonresidential fixed investment also gains, but the 2.4% rise is markedly lower than the 3.8% expected for 1989; with corporate profits under pressure this sector is at risk.

* Real net exports are projected to gain but not much; the -$54 billion (1982 dollars) estimate would be only a $6 billion improvement after roughly a $15 billion advance in 1989.

Among other characteristics of the forecast, the panel sees little change in the average unemployment rate (5.5% in 1990 versus 5.3% in 1989), slower industrial production gains (1.6% compared with 3.3%), lower car and truck sales (14.7 million in 1990 versus 15.1 million this year), but a modest recovery in housing starts (1.45 million after 1.40 million in 1989).

Twin Deficits to Persist. The NABE forecasters see both the merchandise trade and federal budget deficits sinking but only very slowly. For 1990 the trade imbalance should be about $100 billion (down from $109 billion in 1989) and federal spending will exceed revenue by $141 billion (after a reported $152.0 billion in fiscal 1989). Contentious debates over the budget are likely in this environment, and the G-7 nations will face continuing challenges in promoting adjustment of trade and capital flows internationally and in stabilizing currency markets.

Inflation and Interest Rate Outlook is Favorable. One of the benefits of the sluggish economy portrayed in the median forecast is some progress in reducing inflation:

* The change in the CPI during 1989Q4 - 1990Q4 is put at 4.2% after an estimated 4.6% in the prior four quarters.

* For 1990 on average, the rise slows to 4.2% from the 4.8% rise recorded in 1989.

The NABE panel has become more optimistic about inflation, as these estimates for 1990 have been reduced over the last three surveys.

Lower interest rates are also in prospect according to the panel. For 90 day Treasury Bills the 1990 average is projected to be 7.1% compared with 8.1% in 1989. For 30 year Treasury Bonds, the estimate is 7.8% in 1990 versus 8.4% in 1989. The panel sees declines in the near term for bills but little variation over the next five quarters for long term bonds, as shown below.

	1989Q4	1990Q1	1990Q2	1990Q3	1990Q4
Treasury Bills	7.5%	7.3%	7.0%	7.0%	7.0%
Treasury Bonds	7.9%	7.8%	7.8%	7.8%	7.9%

Dispersion and Disagreements. We noted at the beginning the differences of opinion about the likelihood of a recession. On a numerical basis, however, the forecasts for 1990's real GNP do not show huge variation; with the median estimate of growth over 1989Q4 - 1990Q4 at 2.0%, the upper quartile of forecasters comes in at 2.7% and the lower quartile at 1.4%. There is only a small difference in the medians of forecasters who classify themselves as Keynesians, Monetarists, or other. Similarly, there is no big disparity between forecasts based upon the sector in which the forecaster works. See the panel below for details. It is possible, of course, to find more dispersion among forecasts on some of the volatile components such as capital spending, industrial production, and corporate profits.

Group	Estimate of Real GNP Change 1989Q4 - 1990Q4
Overall median	2.0%
Upper quartile	2.7%
Lower quartile	1.4%
Median by theoretical framework	
Keynesians	2.1%
Monetarists	1.8%
Others	2.0%
Median by sector of employment	
Goods producing	2.0%
Trade, transportation, utility and communication	1.7%
Other services	2.0%

1989 Results and Forecast

When the NABE forecast panel presented its latest estimates for 1989, three quarters of actual data were in (with the preliminary estimate for 1989Q3 GNP just reported). A complete record of this final 1989 forecast is provided in Table 1, but a few highlights are shown in the panel below along with the forecast made last February as the year was beginning.

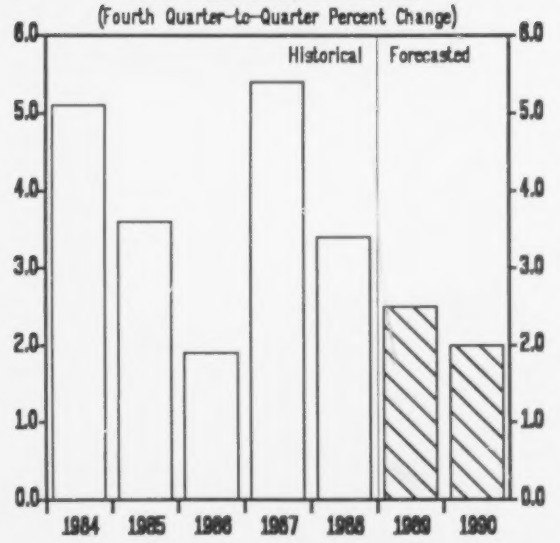
Forecast Variable	February 1989 Forecast	November 1989 Forecast
Real GNP change (1988Q4-1989Q4)	2.5%	2.5%
Real GNP change (1989 average)	2.7%	2.9%
Personal consumption expenditure	2.5%	2.7%
Nonresidential fixed investment	4.0%	3.8%
Real net exports (billions of 1982$)	-$85.0	-$60.0
Merchandise trade balance (billions of $)	-$103.0	-$109.0
Federal budget deficit (billions of $)	-$155.0	-$152.0
Corporate profits (% change, current $)	+6.3%	-3.3%
Consumer price change (1988Q4-1989Q4)	4.8%	4.6%
Consumer price change (1989 average)	4.7%	4.8%
Treasury bills (1989 average)	8.0%	8.1%
Treasury bonds - 30 year (1989 average)	9.2%	8.7%

Real GNP and Components. NABE forecasters believe that 1989 will go into the record books fairly close to the forecasts made at the beginning of the year. Real GNP growth over the four quarter span is now expected to be 2.5%, exactly the forecast made in February; measured with year averages the advance is projected now at 2.9% or slightly more than the 2.7% foreseen at the start of the year. By component, the gains in consumer expenditures and business investment appear to be on track with the February expectations, but real net exports have done better; a substantial upward correction in the July revisions to the GNP accounts, however, boosted the net export figures sharply and is mainly responsible for the more favorable outcome.

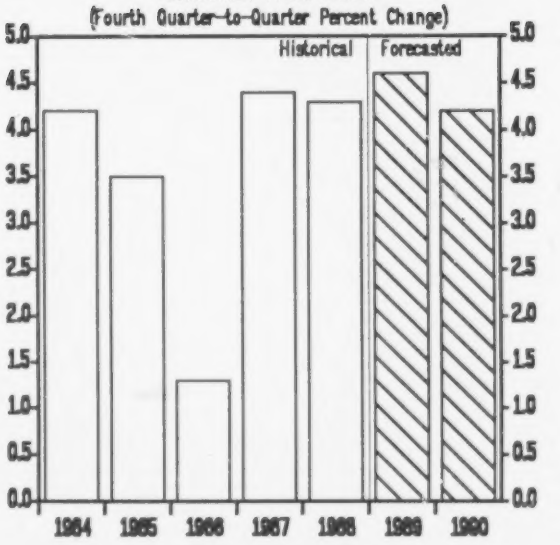
Trade, Budget and Profits. The nominal merchandise trade and budget deficits have come in near expectations. The trade imbalance is now projected at $109 billion, a little worse than the $103 billion originally forecast but a gain from the 1988 actual result of $118.5 billion. The Federal budget deficit was projected to be $152.0 billion in the last forecast and has now been reported for fiscal 1989 at $152.0; the result is near the February estimate of $155 billion. On profits, however, the results have been coming in substantially worse than expected: the February forecast looked for +6.3% while the latest estimate shows -3.3%, and after preliminary third quarter data are accounted for (just released at this writing but unavailable when the forecasts were submitted) the estimate will likely be lowered further.

Inflation and Interest Rates. The inflation pattern reflected in the Consumer Price Index appears to have been about as expected early in the year. The four quarter change in February was forecast to be 4.8% and is now put at 4.6%; the year average was 4.7% and is now 4.8%. The average interest rate on 90 day T-bills was forecasted at 8.0% and is 8.1% in the recent inquiry. The outcome on 30 year T-bonds, however, has been lower than the early forecast, i.e., 8.4% versus the original 9.2%.

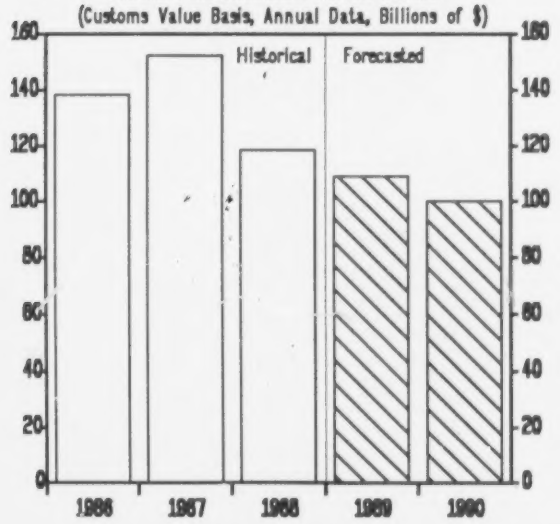
REAL GROSS NATIONAL PRODUCT
(Fourth Quarter-to-Quarter Percent Change)



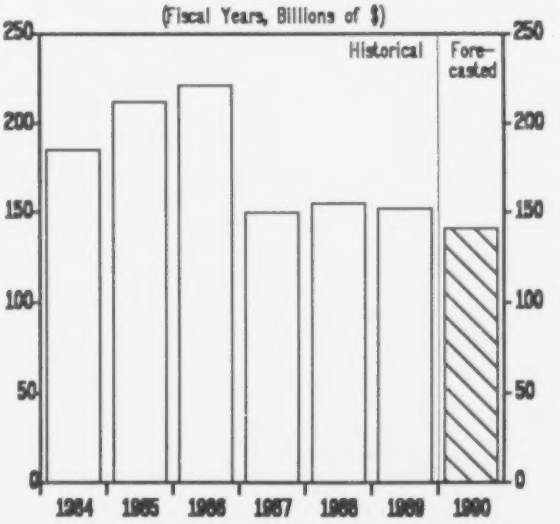
CONSUMER PRICE INDEX
(Fourth Quarter-to-Quarter Percent Change)



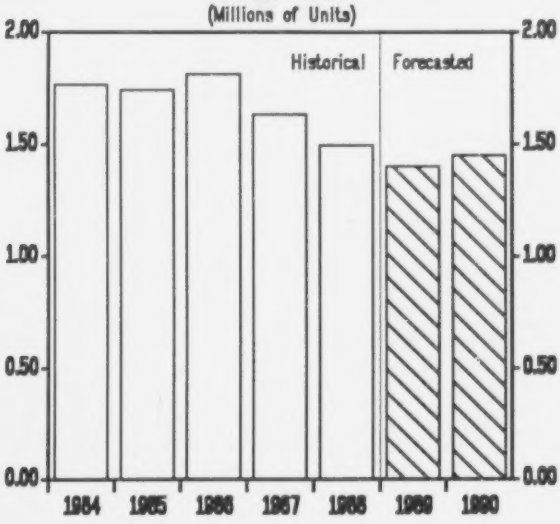
ANNUAL MERCHANDISE TRADE DEFICIT
(Customs Value Basis, Annual Data, Billions of $)



ANNUAL BUDGET DEFICIT
(Fiscal Years, Billions of $)



HOUSING STARTS
(Millions of Units)



TOTAL VEHICLE SALES
(Millions of Units)

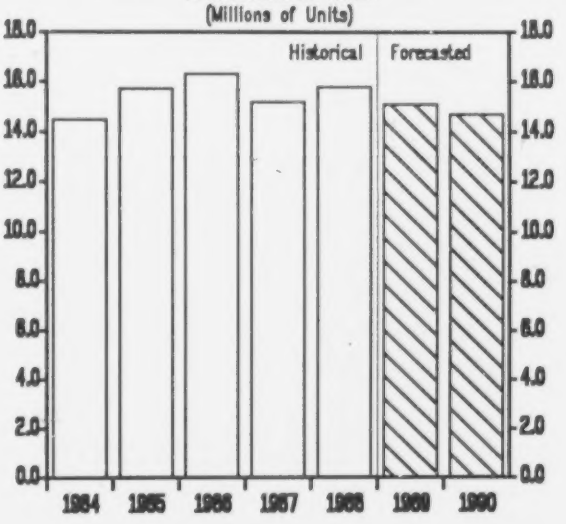


Table 1

SUMMARY OF NABE MEDIAN FORECASTS

	1988 Actual	1989 FORECASTS Feb 89 Survey	May 89 Survey	Aug 89 Survey	Nov 89 Survey	1990 FORECASTS May 89 Survey	Aug 89 Survey	Nov 89 Survey
FOURTH QUARTER TO FOURTH QUARTER								
Real GNP	3.4%	2.5%	2.3%	2.1%	2.5%	2.3%	2.2%	2.0%
Consumer Price Index	4.3%	4.8%	5.3%	5.0%	4.6%	4.7%	4.3%	4.2%
ANNUAL AVERAGES								
Real GNP	4.4%	2.7%	2.8%	2.6%	2.9%	1.8%	1.8%	1.8%
Personal consumption expend.	3.4%	2.5%	2.5%	2.2%	2.7%	1.9%	1.9%	2.1%
Nonresidential fixed investment	8.4%	4.0%	4.6%	3.6%	3.8%	1.8%	2.7%	2.4%
Net exports (Billions 82$)	-$74.9	-$85.0	-$90.0	-$53.0	-$60.0	-$76.0	-$47.0	-$54.0
Nominal Magnitudes:								
Merchandise trade balance	-$116.5	-$103.0	-$112.0	-$110.0	-$109.0	-$100.0	-$100.0	-$100.0
Fed budget deficit (FY)	-$155.1	-$155.0	-$160.0	-$150.0	-$152.0	-$140.0	-$135.0	-$141.0
Corporate profits (after tax)	18.9%	6.3%	5.3%	2.5%	-3.3%	1.9%	2.0%	-1.0%
Real Magnitudes:								
Unemployment rate (civ)	5.5%	5.5%	5.4%	5.3%	5.3%	5.8%	5.7%	5.5%
Industrial production	5.7%	3.4%	3.2%	3.1%	3.3%	1.8%	1.7%	1.6%
Housing starts (MM)	1.49	1.44	1.41	1.42	1.40	1.44	1.45	1.45
Total vehicle sales (MM)	15.8	15.3	14.9	15.0	15.1	14.9	14.7	14.7
Autos	10.6	10.2	9.9	10.0	10.1	9.9	9.8	9.8
Domestic	7.5	7.3	7.1	7.1	7.2	7.1	7.0	7.0
Imports	3.1	2.9	2.8	2.9	2.9	2.8	2.8	2.8
Trucks	5.2	5.1	5.0	5.0	5.0	5.0	4.9	4.9
Inflation and Interest Rates:								
Consumer Price Index	4.1%	4.7%	5.1%	5.0%	4.8%	4.8%	4.5%	4.2%
GNP deflator	3.3%	4.5%	4.6%	4.4%	4.2%	4.4%	4.2%	4.0%
Treasury bills (3 mo.)	6.7%	8.0%	8.6%	8.1%	8.1%	7.6%	7.3%	7.1%
Treasury bonds (30 yr.)	9.0%	9.2%	9.1%	8.4%	8.4%	8.8%	7.9%	7.8%

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NABE Outlook

NABE MACROECONOMIC FORECAST RESULTS

NABE FORECAST PANEL SEES SLUGGISH ECONOMY IN 1990 FOLLOWED BY STRONGER 1991; INFLATION PROJECTED TO REMAIN NEAR 4%

February 1990

This report presents the consensus of macroeconomic forecasts made by a panel of 65 professional forecasters from the membership of the National Association of Business Economists. This survey is one of three taken regularly by NABE; the other inquiries are the NABE Industry Survey and the NABE Economic Policy Survey

Richard D. Rippe
Vice President, NABE
Senior Vice President & Economist
Dean Witter Reynolds Inc.

James Annable
NABE Public Affairs Committee
Chief Economist
First Chicago Corporation

Highlights

* A majority of NABE Macro forecasters (60.6%) believe that the U.S. economy will avoid recession over the next three years.

* But the risk of recession is not trivial; the median probability of a downturn in the next twelve months is 28% and almost half of the panel say the risk has increased in the last quarter.

* The economy is expected to be sluggish in 1990 with real GNP up 1.7% on average; in 1991 the pace is projected to accelerate to 2.5%.

* Inflation is expected to remain near 4% in both 1990 and 1991 on both the CPI and the GNP deflator.

* The recent rise in interest rates is viewed as a temporary phenomenon; rates on both 3 month T-bills and 30 year T-bonds are expected to decline over the next several quarters and then to be relatively flat.

* If the NABE economic forecasts are near the mark, they hold disappointments for policymakers:

  - little progress would be made over the next two years in achieving the zero inflation goal enunciated by the Federal Reserve;

  - the performance of the economy would produce a larger budget deficit than the Bush Administration estimates.

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Recession or Expansion?

In a period of transition and heightened concerns such as the present, questions about whether the expansion will persist inevitably arise. The NABE macroeconomic forecasters continue to believe that the economy will avoid an outright recession. In the latest survey (reflecting forecasts made in late January/early February 1990), panelists were again asked if they expect a recession in the next three years:

* A majority (60.6%) replied no, and this proportion is just slightly lower than what was found in the prior quarter (i.e. when 62.1% thought there would be no recession).

* Of the 39.4% who think a recession will occur in the next three years, about half (18.1% of the total respondents) believe it began in 1989Q4 or will commence in 1990.

In this survey, however, we asked about the recession/expansion issue in another way as well: What is the probability of recession in the next twelve months and how has the probability changed over the last quarter? The median probability assigned by the panel is 28%, but perhaps even more revealing is how it has changed: 46.2% of the forecasters say the probability has increased, 32.3% say there has been no change, and only 21.5% believe the recession risk has decreased.

Thus even though the best guess is no recession in either the next twelve months or even as far ahead as three years, the economy is in a danger zone; the probability of recession is not trivial, and almost 80% of respondents think it has risen or remained the same over the last quarter.

1990 Economic Outlook

The general shape of the economy in 1990 remains one of slow growth with a somewhat lower rate of inflation. The basic outlines of the forecast have changed very little between our last two surveys, although the panel sees some of the cyclical components -- investment, housing, automobile sales, industrial production, corporate profits -- weaker than before.

The details of the 1990 forecast -- using medians for all variables -- may be found in Table 1 (under the February 1990 survey date). Here are some of the central results:

* Real GNP is expected to grow 2.0% on a fourth quarter-to-fourth quarter basis, and 1.7% on the year average basis.

* In the GNP total there is little change from the prior estimates and a number of the components are very similar as well including consumer spending (+2.2%), real net exports (-$53 billion 1982 dollars), and the civilian unemployment rate (5.6%).

* The cyclically sensitive parts of the economy now look to be weaker to the NABE forecasters. On the year average basis the predictions are changed as follows:

	Prior Survey	Latest Survey
Nonresidential fixed investment	+2.4%	+1.9%
Industrial production	+1.6%	+1.3%
Housing starts	1.45 million	1.40 million
Total vehicle sales	14.7 million	14.5 million
Corporate profits	-1.0%	-3.5%

The downward revisions in these measures are consistent with the assessment, noted above, that the probability of recession has risen.

1991 Economic Outlook

The initial estimates for 1991 from the NABE panel are introduced in this report. Next year growth is expected to rebound, but inflation is projected to be stuck near current levels, i.e. about 4%. Table 1 also provides the forecast data for next year.

The key dimensions of economic performance in 1991 are projected as follows:

* Real GNP advances 2.6% on the fourth quarter-to-fourth quarter basis and 2.5% on average.

* The cyclical components rebound, with real nonresidential fixed investment +3.0% (on the year average basis), industrial production +3.0%, housing starts up to 1.45 million units, total vehicle sales at 15.0 million, and corporate profits +9.0%.

* Neither deterioration nor further improvement is expected in the inflation readings: the CPI rise over the four quarters of 1991 is projected at 4.2% (versus 4.3% in 1990) and the year average is also put at 4.2% (the same as the prediction for 1990).

Interest Rate Forecasts for 1990-1991

NABE forecasters expect little movement in interest rates over the entire period 1990-1991. Thus the recent rise is seen as a temporary phenomenon rather than an enduring trend. Median predictions for 3 month Treasury Bills and 30 year Treasury Bonds are shown by quarter in the panel below:

	1990Q1	1990Q2	1990Q3	1990Q4	1991Q1	1991Q2	1991Q3	1991Q4
T-Bills	7.5%	7.2%	7.1%	7.2%	7.2%	7.3%	7.3%	7.3%
T-Bonds	8.2	8.0	8.0	8.0	8.0	8.0	8.0	8.0

Bad News for Policy Makers

If the latest NABE median forecasts prove near the mark, they contain some disappointments from the perspectives of recently endorsed policy objectives.

Federal Reserve Target of Zero Inflation. A number of Federal Reserve governors have stated that zero inflation should be the goal a few years hence; several have testified in support of the bill offered by Congressman Stephen Neal (D., N.C.) that directs the Fed to conduct monetary policy in such a way as to eliminate inflation over the next five years and to maintain price stability thereafter. While the exact time path is not specified, the NABE forecasters project inflation in both 1990 and 1991 near 4%. These rates are slightly better than the 1989 results, but this pattern would surely be disappointing to the Fed. NABE forecasters believe either that the environment will not be conducive to achieving the desired deceleration or that the monetary authorities will be either unable or unwilling to run a restrictive enough policy to produce a significant further slowdown. Only if the minority of forecasters who project a recession are correct (albeit with the increased risk acknowledged by the whole panel) is a sharp improvement in inflation probable.

Economic Assumptions in the Budget Appear Optimistic. The budget estimates made by the Bush Administration are based upon specific economic projections. The following tabulation compares the Administration, Congressional Budget Office, and NABE forecasts for three central magnitudes; all estimates are on the calendar (as opposed to fiscal) year basis and are for the year on average.

	1990 Forecasts			1991 Forecasts		
	Admin	CBO	NABE	Admin	CBO	NABE
Real GNP Growth	2.6%	1.7%	1.7%	3.3%	2.4%	2.5%
GNP Deflator	4.1	4.0	4.0	4.2	4.0	3.9
Treasury Bills	6.7	6.9	7.2	5.4	7.2	7.3

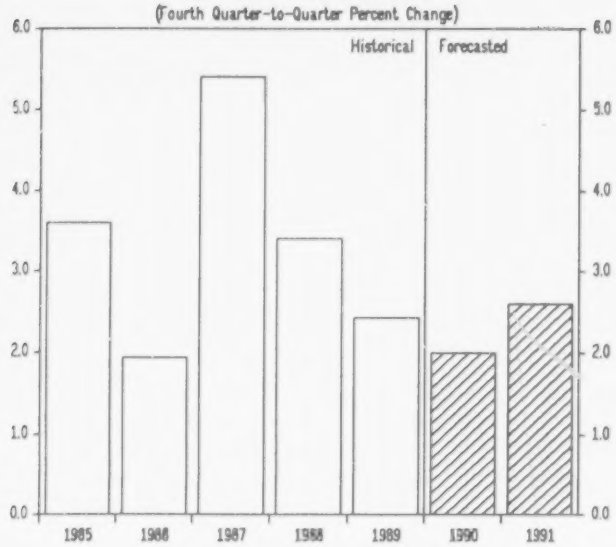
There is agreement on the near-term inflation outlook with all estimates for both years near 4%. Unfortunately for the budget outlook, this is the least critical of the measures shown since both revenue and expenditures respond to the same extent; hence the direct impact of a modestly higher or lower inflation forecast is minimal.

On the other variables, there are important differences. If the NABE estimates are near the mark, revenue growth will be lower than the Bush Administration projects and interest outlays will be higher. The NABE forecasts are substantially closer to those of the Congressional Budget Office (CBO) than to those of the Administration. It should be noted, however, that the Council of Economic Adviser's had an optimistic forecast for 1989 that proved to be correct.

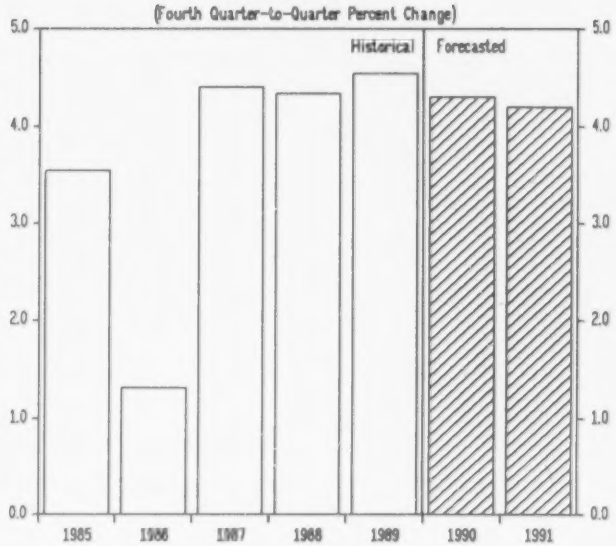
Deficit Forecasts. The NABE survey also shows forecasts of the budget deficit for the current and succeeding fiscal years. For fiscal 1990 the estimate is -$140 billion and for 1991 -$120 billion. In contrast the Gramm-Rudman-Hollings targets are -$100 billion and -$64 billion, respectively.

On the other deficit, the merchandise trade gap, the median prediction shows only small gains. After the reported -$108.6 billion in 1989, the NABE panel projects -$105 billion in 1990 and -$99 billion in 1991.

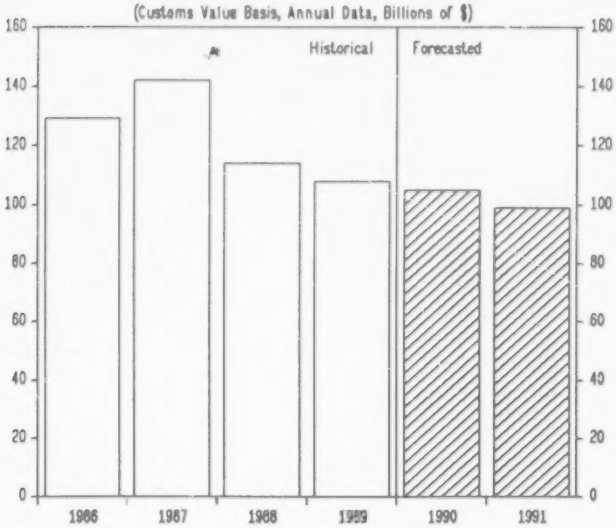
REAL GROSS NATIONAL PRODUCT
(Fourth Quarter-to-Quarter Percent Change)



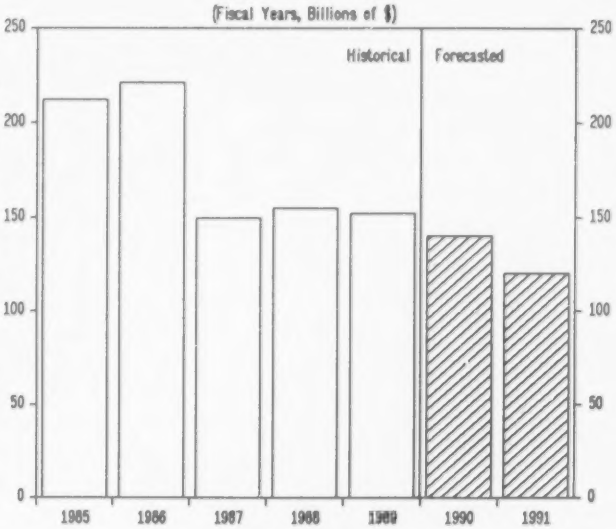
CONSUMER PRICE INDEX
(Fourth Quarter-to-Quarter Percent Change)



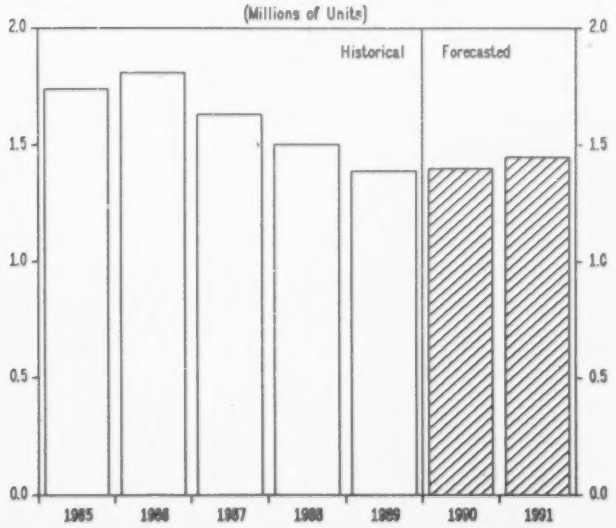
ANNUAL MERCHANDISE TRADE DEFICIT
(Customs Value Basis, Annual Data, Billions of $)



ANNUAL BUDGET DEFICIT
(Fiscal Years, Billions of $)



HOUSING STARTS
(Millions of Units)



TOTAL VEHICLE SALES
(Millions of Units)

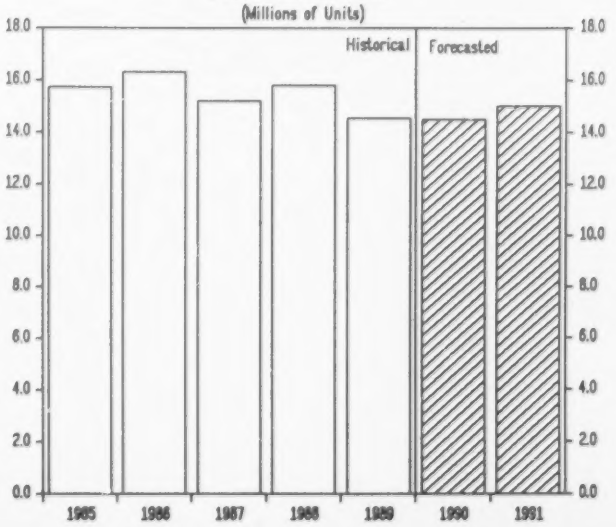


Table 1
SUMMARY OF NABE MEDIAN FORECASTS

		1990 FORECASTS				1991 FORECAST
	1989 Actual	May 89 Survey	Aug 89 Survey	Nov 89 Survey	Feb 90 Survey	Feb 90 Survey
FOURTH QUARTER TO FOURTH QUARTER						
Real GNP	2.4%	2.3%	2.2%	2.0%	2.0%	2.6%
Consumer Price Index	4.5%	4.7%	4.3%	4.2%	4.3%	4.2%
ANNUAL AVERAGES						
Real GNP	2.9%	1.8%	1.8%	1.8%	1.7%	2.5%
Personal consumption expend.	2.7%	1.9%	1.9%	2.1%	2.2%	2.4%
Nonresidential fixed investment	3.5%	1.8%	2.7%	2.4%	1.9%	3.0%
Net exports (Billions 82$)	-$56.3	-$76.0	-$47.0	-$54.0	-$53.0	-$45.0
Nominal Magnitudes:						
Merchandise trade balance	-$108.6	-$100.0	-$100.0	-$100.0	-$105.0	-$99.0
Fed budget deficit (FY)	-$152.1	-$140.0	-$135.0	-$141.0	-$140.0	-$120.0
Corporate profits (after tax)	-6.0%	1.9%	2.0%	-1.0%	-3.5%	9.0%
Real Magnitudes:						
Unemployment rate (civ)	5.3%	5.8%	5.7%	5.5%	5.6%	5.5%
Industrial production	3.4%	1.8%	1.7%	1.6%	1.3%	3.0%
Housing starts (MM)	1.39	1.44	1.45	1.45	1.40	1.45
Total vehicle sales (MM)	14.8	14.9	14.7	14.7	14.5	15.0
Autos	9.9	9.9	9.8	9.8	9.6	10.0
Domestic	7.1	7.1	7.0	7.0	6.9	7.2
Imports	2.8	2.8	2.8	2.8	2.7	2.8
Trucks	4.9	5.0	4.9	4.9	4.9	5.0
Inflation and Interest Rates:						
Consumer Price Index	4.8%	4.8%	4.5%	4.2%	4.2%	4.2%
GNP deflator	4.2%	4.4%	4.2%	4.0%	4.0%	3.9%
Treasury bills (3 mo.)	8.1%	7.6%	7.3%	7.1%	7.2%	7.3%
Treasury bonds (30 yr.)	8.4%	8.8%	7.9%	7.8%	8.0%	8.0%

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NABE Outlook & Policy Survey

NABE PANEL LOWERS 1990-91 SIGHTS; ASSESSES IMPACT OF PROSPECTIVE POLICY CHANGES

September 1990

This report presents the consensus of macroeconomic forecasts made by a panel of 71 professional forecasters from the membership of the National Association of Business Economists and also the results of a survey of 242 NABE members on economic policy issues. These results were presented at the NABE Annual Meeting in Washington, DC, on September 25.

Richard D. Rippe, Vice President, NABE
Senior Vice President & Chief Economist
Dean Witter Reynolds Inc.

Highlights

* Forecasts of real GNP growth have been sharply reduced to 1.1% over the four quarters of 1990 (versus the prior 2.1%) and to 1.9% over the four quarters of 1991 (versus the previous 2.5%).

* Inflation during the period 1989Q4-1990Q4, as measured by the CPI, is being boosted by the oil price surge to 5.8% (versus the prior estimate of 4.7%). For 1991, however, the estimate is little changed at 4.4% (versus 4.3%).

* The risk of recession is significantly higher than it was in the prior survey: The median probability in the next twelve months is 50% (versus 20% previously), and 60% of the respondents expect a recession within the next three years (versus 36% previously).

* Monetary policy is viewed as too restrictive by 56% of respondents in the latest policy survey. About two-thirds of the economists expect easing action in the next six months.

* If the Federal Reserve is confronted with sustained higher oil prices and a significant budget deal, only 33% of the panel expect an unchanged policy strategy; 58% predict the Fed will ease to counter recessionary pressures.

* The vast majority of economists advise changes in energy policy to encourage development of new supplies, conservation, or both. Many economically sound proposals, however, are regarded as fraught with political difficulties.

* A number of policy issues vital to U.S. competitiveness remain to be resolved in the Uruguay round of GATT negotiations. The policy panel is pessimistic about the outcome.

* Median estimates of long-run economic prospects put five-year real GNP growth at 2.5% per annum, productivity at 1.3%, and inflation (in the CPI) at 4.2%.

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ECONOMISTS BECOME MORE PESSIMISTIC: 1990–1991 FORECAST

The NABE panel of macroeconomic forecasters has become much more pessimistic over the last three months: GNP estimates have been reduced markedly, while the near–term inflation forecasts have been boosted. A few rays of hope are apparent, however, in that next year's inflation estimate (measured from fourth quarter to fourth quarter) is changed very little, and the forecast of interest rates in 1991 has been lowered.

Real GNP Estimates

The NABE consensus (the median of estimates from 71 professional macroeconomic forecasters) has been lowered sharply over the last three months for both 1990 and 1991. The changes may be seen in the following panel:

	% Change Q4–Q4		% Change Annual Average	
Year	As of May 1990	As of Aug. 1990	As of May 1990	As of Aug. 1990
1990	2.1%	1.1%	2.0%	1.2%
1991	2.5	1.9	2.4	1.4

The estimates for 1990 have been cut almost in half, and those for 1991 have been significantly pared as well. Since the previous estimates were not robust, these revisions represent important changes in the panel's view of the economic outlook. They also represent a serious threat to continuation of the expansion, a topic to be addressed later.

The adjustment to the forecast reflects, among other things, annual data revisions released in July, new monthly indicators of economic conditions, the impact of higher oil prices, and prospective changes in economic policy. We cannot precisely quantify how much of the change comes from each source, but for 1990 a rough calculation of the impact of the annual revision to the National Income Accounts can be made. In the May survey, respondents predicted real GNP to rise 2.1% over the four quarters of 1990. Assuming that the growth would be distributed roughly equally over the remaining three quarters of the year, each of them would have run at about 2.1% annual rates (or about the same rate as shown in the original report of 2.1% for 1990Q1). Given the revised data on the first half of 1990, however, this rate of gain for the second half of the year would produce a total rise of 1.8%. So the data revisions appear to account for about 0.3% of the downward adjustment to our 1990 estimates; the remaining 0.7% reflects a combination of the other factors.

GNP Components and Activity Measures

The reduced GNP growth is derived from more subdued prospects in the major demand categories. Real consumption expenditures in 1990 show growth of 1.2% (on the year average basis), down from 2.0% in the prior survey; in 1991 consumption is now projected to grow 1.4% versus 2.4% earlier. Nonresidential fixed investment is also expected to be lethargic, with a 1.0% advance in 1990 (versus the prior forecast of 2.3%) and 1.2% in 1991 (compared with the earlier estimate of 3.3%). An exception to the downward revisions is real net exports, where prospects have improved, with current expectations of –$38.0 billion (1982 dollars) versus the previous –$44.0 billion in 1990 and –$31.0 billion revised from –$40 billion in 1991. Weaker domestic demand and the lower value of the dollar are the primary boosters of the real trade balance.

TABLE 1

SUMMARY OF NABE MEDIAN FORECASTS

	1989 Actual	1990 FORECASTS Aug 89 Survey	Nov 89 Survey	Feb 90 Survey	May 90 Survey	Aug 90 Survey	1991 FORECAST Feb 90 Survey	May 90 Survey	Aug 90 Survey
FOURTH QUARTER TO FOURTH QUARTER									
Real GNP	2.4%	2.2%	2.0%	2.0%	2.1%	1.1%	2.6%	2.5%	1.9%
Consumer Price Index	4.5%	4.3%	4.2%	4.3%	4.7%	5.8%	4.2%	4.3%	4.4%
ANNUAL AVERAGES									
Real GNP	2.5%	1.8%	1.8%	1.7%	2.0%	1.2%	2.5%	2.4%	1.4%
Personal consumption expend.	1.9%	1.9%	2.1%	2.2%	2.3%	1.0%	2.4%	2.5%	1.4%
Nonresidential fixed investment	3.9%	2.7%	2.4%	1.9%	2.7%	0.9%	3.0%	3.3%	1.2%
Net exports (Billions 82$)	-$54.1	-$47.0	-$54.0	-$53.0	-$44.0	-$38.0	-$45.0	-$40.0	-$31.0
Nominal Magnitudes:									
Merchandise trade balance	-$108.6	-$100.0	-$100.0	-$105.0	-$100.0	-$95.0	-$99.0	-$95.0	-$90.0
Fed budget deficit (FY)	-$152.1	-$135.0	-$141.0	-$140.0	-$154.0	-$165.0	-$120.0	-$135.0	-$171.0
Corporate profits (after tax)	-4.4%	2.0%	-1.0%	-3.5%	-1.7%	-2.7%	9.0%	6.6%	3.0%
Real Magnitudes:									
Unemployment rate (civ)	5.3%	5.7%	5.5%	5.6%	5.4%	5.5%	5.5%	5.4%	5.9%
Industrial production	2.6%	1.7%	1.6%	1.3%	1.3%	1.1%	3.0%	3.0%	1.6%
Housing starts (MM)	1.39	1.45	1.45	1.40	1.38	1.25	1.45	1.40	1.29
Total vehicle sales (MM)	14.8	14.7	14.7	14.5	14.6	14.4	15.0	14.9	14.5
Autos	9.9	9.8	9.8	9.6	9.6	9.5	10.0	9.9	9.6
Domestic	7.1	7.0	7.0	6.9	6.9	6.8	7.2	7.1	6.9
Imports	2.8	2.8	2.8	2.7	2.7	2.7	2.8	2.8	2.7
Trucks	4.9	4.9	4.9	4.9	4.9	4.9	5.0	5.0	4.9
Inflation and Interest Rates:									
Consumer Price Index	4.8%	4.5%	4.2%	4.2%	4.7%	5.3%	4.2%	4.3%	4.9%
GNP deflator	4.1%	4.2%	4.0%	4.0%	4.1%	4.3%	3.9%	4.0%	4.4%
Treasury bills (3 mo.)	8.1%	7.3%	7.1%	7.2%	7.8%	7.6%	7.3%	7.7%	7.0%
Treasury bonds (30 yr.)	8.4%	7.9%	7.8%	8.0%	8.6%	8.6%	8.0%	8.5%	8.3%

(3

Forecasts of other activity measures also reveal a weaker pattern, as illustrated in Table 1. In particular, the unemployment rate in 1991 is now projected to be 1/2 percent higher at 5.9%. Industrial production growth has been cut nearly in half, to 1.6% from the previous projection of 3.0%. Housing start estimates have been lowered to 1.25 million in 1990 and 1.29 million in 1991. Automobile sales are seen stuck at a 9.5 million rate, and total vehicle sales are projected at about 14.5 million in both years.

Trade and Budget Deficits Diverge

Many of the concerns about the economy in the second half of the 1980's were expressed in terms of the twin deficits — imbalances in the trade and federal government accounts. Although economists argued that the two were not tightly tied together, much public discussion presumed a linkage because there was deterioration in both measures. Now the NABE forecasters look for divergence in the patterns.

In the trade arena, real net exports are projected to score improvements in both 1990 and 1991, as noted earlier. The gains we project here are not based upon revisions to the GNP accounts, since there were only small changes in the July release, and the 1989 figure was actually changed to show a slightly larger deficit. Rather, the optimism is based upon fundamentals such as demand growth overseas, an improved trend in competitiveness of U.S. industries, and, more recently, the further decline in the value of the dollar. The nominal trade numbers also show a gain, but a smaller one, since the impact of higher oil prices will offset some of the growth in export volume. The NABE forecasters look for the merchandise trade balance to be –$95.0 billion in 1990 and –$90.0 billion in 1991 compared with the –$108.6 billion reported for 1989.

The federal budget deficit has been worsening since early this year, reflecting the weak economy (and the attendant shortfall of tax receipts from prior expectations), along with the buildup of financing costs for the savings and loan rescue — particularly the large working capital needs. We asked the panel for estimates of the budget deficit excluding the S&L impact, and the median estimates show –$165 billion for fiscal 1990 and –$171 billion for fiscal 1991 following the reported –$152.1 billion for 1989. (Excluding costs incurrred by the Resolution Trust Corporation, the 1989 deficit is estimated at –$143 billion). If costs for the savings and loans were added to the NABE estimates, the 1990 figure would be about –$225 billion and that for 1991, –$240 billion. We will have more to say about budget policy a bit later.

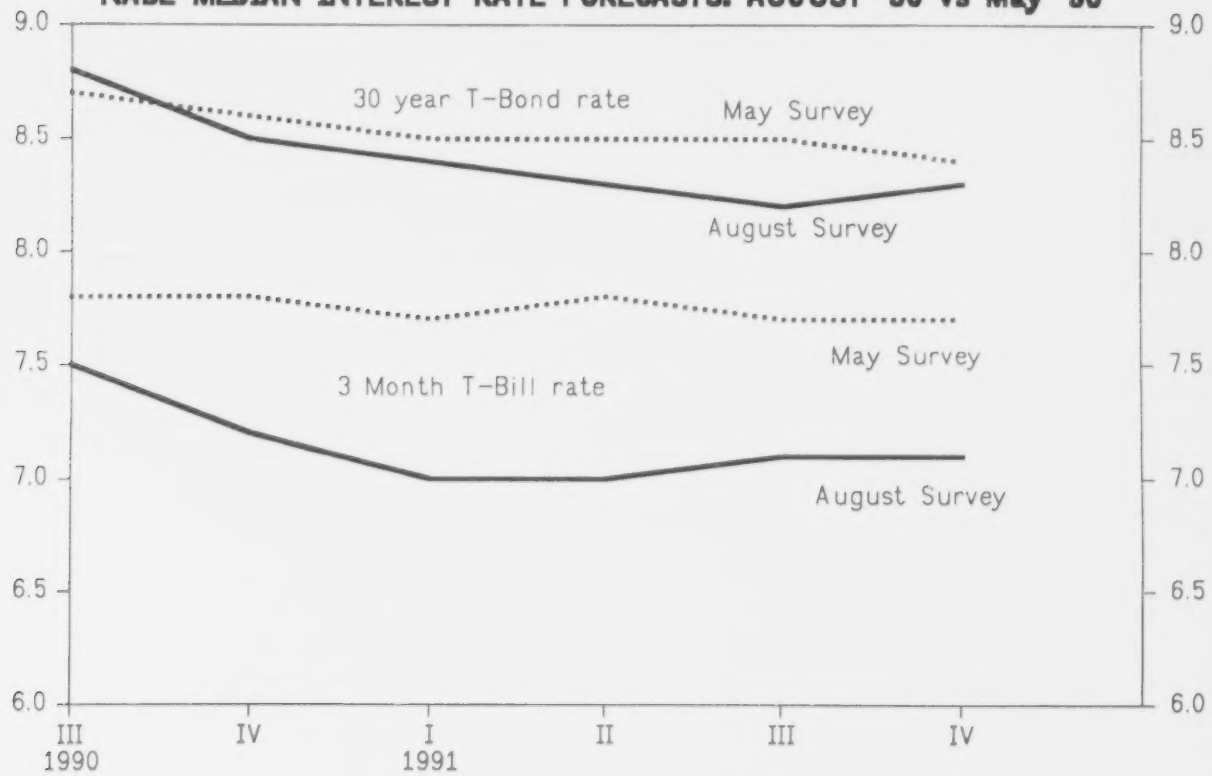
Inflation and Interest Rates

The oil price spurt has pushed up the 1990 inflation estimates. Economists now forecast that the CPI will advance 5.8% over the four quarters of 1990, whereas in our prior survey the rise was put at 4.7%. On an annual average basis, the revision is up to 5.3% from the previous 4.7%. But when we turn to the prospects for 1991, the message is more positive: Over the four quarters of next year, the CPI is projected at 4.4% (little changed from 4.3% in the previous survey), although the higher base in the second half of this year pushes next year's annual average up to 4.9% (versus the prior estimate of 4.3%).

Interest rates on long–term bonds have been boosted over the last two months by the inflation pressure and uncertainty surrounding the oil crisis, as may be seen in Chart 1. But for 1991 the panel has become more optimistic in the presence of a weaker economy, so the yield on 30–year Treasury bonds is now expected to average about 20 basis points less than in the prior forecast. The improved interest rate outlook is even clearer in short maturities (see Chart 1). The average interest rate on

Chart 1

NABE MEDIAN INTEREST RATE FORECASTS: AUGUST '90 vs May '90



Treasury Bills for 1990 is now put at 7.6% (compared with 7.8% in the prior survey) and at 7.0% in 1991 (versus 7.7% previously).

Differences Among Forecasts and Forecasters

The summary figures presented thus far are medians of the individual forecasts. There is, however, considerable variation among the estimates. For the period 1990Q4–1991Q4, the highest decile has average real GNP growth of 2.9% while the lowest has only 0.6%, compared with a median of 1.9%. Since a wide variety of information and conceptual reasoning is embedded in each forecast, such differences are not surprising. Still, we have attempted to see if any characteristics of the forecasters themselves would reveal something about the source of the differences. At this time, there is little variation in the medians when forecasters are grouped by sector of employment and the principal region in which their companies operate.

When the forecasters were segmented in prior surveys by the theoretical framework that underlies their work, often there were no meaningful differences. But in the current instance, the variations are a little larger (see below). Monetarists expect a little faster growth (2.1%) than the whole sample (1.9%), as do those who use rational expectations (2.3%). In the case of monetarists, the strength probably comes from an expectation of easier monetary policy and faster growth of the money supply, which will stimulate the economy. Keynesians (1.6%) forecast slower growth, probably owing to weak demand prospects in major sectors and to some fiscal tightening. There is less difference between monetarists and Keynesians on the inflation outlook as measured by the CPI.

FORECAST OF REAL GNP AND CPI IN 1991
(Medians, % Change 1990Q4–1991Q4)

Theoretical Framework	% of Respondents	Real GNP	CPI
Monetarist	18%	2.1%	4.5%
Keynesian	36	1.6	4.4
Rational expectations	10	2.3	5.0
Other	36	2.0	4.3
Entire sample	100%	1.9	4.4

CYCLICAL PERSPECTIVES

The numerical estimates of GNP, inflation, and the other economic magnitudes tell an important portion of the forecast story, but not all of it.

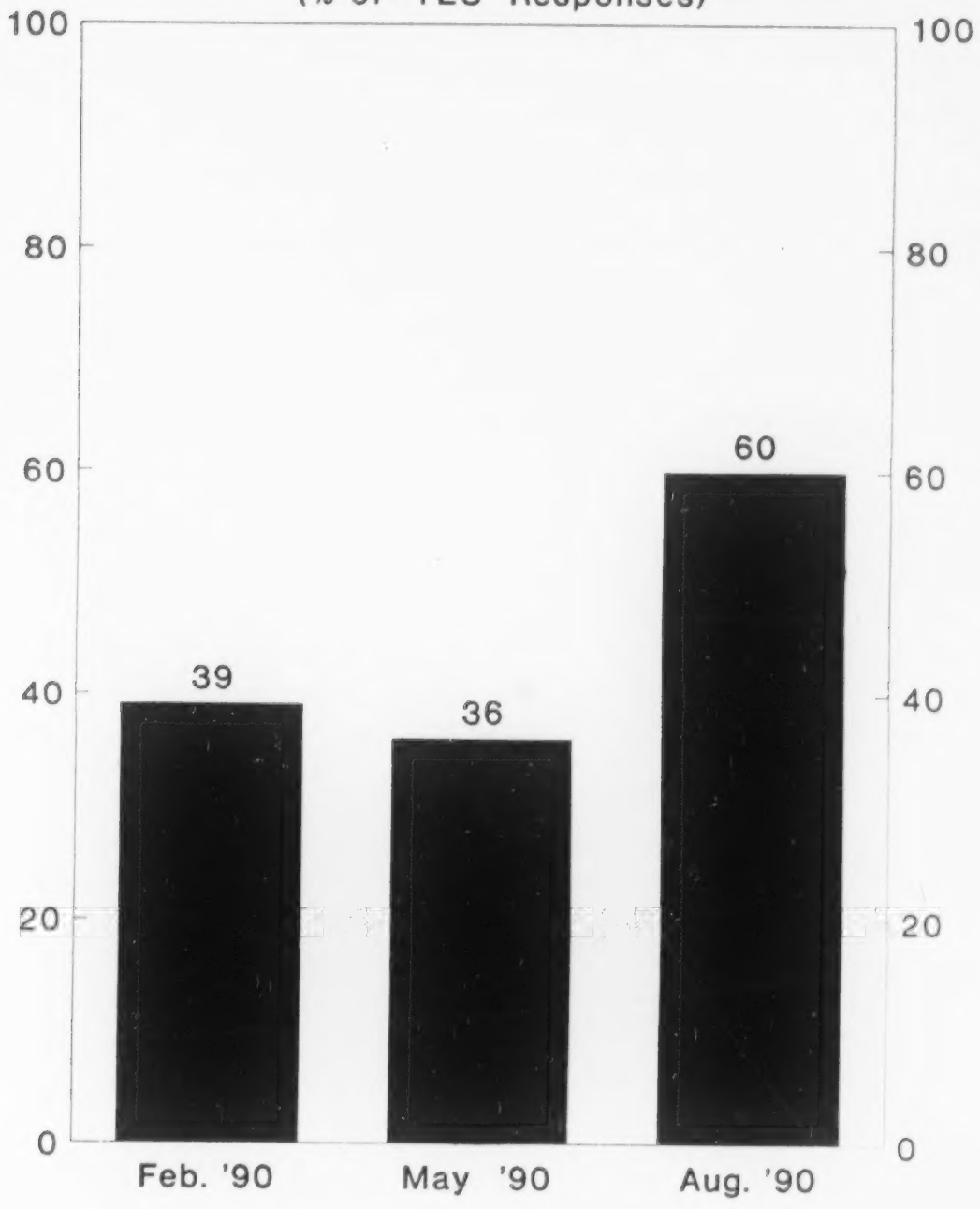
Length of the Expansion

Up until now a large majority of NABE forecasters have expected the expansion to last through 1990 and 1991. Late next year the old record for expansion longevity would be surpassed; the 107th month would be reached in October 1991, while the current record is 106 months (established over the period February 1961 to December 1969). But this prospect is now in jeopardy. Although the me–

Chart 2

A RECESSION IN NEXT 3 YEARS?

(% of "YES" Responses)



dian forecast shows positive real growth in both 1990 and 1991, the pace is slow enough to make two quarters of decline in a row — the informal definition of recession — a distinct possibility.

Probability of Recession

In our recent surveys, we asked economists about the risks of recession in two different ways. First, we posed the question: Do you expect a recession to begin within the next 36 months? There has been a sharp increase in those who responded "yes" in the last survey, to 60% from 36% in the previous survey (see Chart 2). Among those who anticipate recession within the next three years, the majority (76%) believe it has already begun (1990Q2 or Q3) or will begin imminently (1990Q4 or 1991Q1).

The other approach was to ask the questions: What is the probability of a recession within the next 12 months? In the last three months has the probability of recession increased, decreased, or stayed the same? At present the median probability of recession has jumped to 50% from prior readings, which have been in the 20–30% zone (see Chart 3). Moreover, a huge 97% of respondents say that the probability of recession increased within the last three months; 3% believe there was no change.

While the danger of recession has risen sharply, even the most pessimistic of the NABE forecasters are not predicting a disaster. Over the four quarters of 1990, only 3 of the 71 respondents are predicting a decline in real GNP, which would, of course, require fairly sharp drops in the last two quarters of the year, based upon the 1.7% rise already reported in 1990Q1 and the 1.2% reported in the first revision to the estimate for 1990Q2. Over the period 1990Q4–1991Q4, none of the forecasters predict negative growth, although 4 show the year average as negative and 21 have the year average at 1.0% or less. In a number of instances, these estimates contemplate a short, mild recession followed by recovery.

Of course, information and conditions are changing rapidly as this analysis is prepared. The next several quarters promise to be a challenging period for the forecasting community.

Factors Behind Longevity and Recession Risk

Regardless of whether the current expansion surpasses the old record, it will go into the books as one of the longest. The macro forecasters were asked to tell us what fundamentals they believed were most important in generating this performance; three were to be selected from a list of twelve options, where admittedly some of the choices involve a degree of overlap with each other. Chart 4 shows the ranking from high to low:

- Almost 60% of respondents thought effective monetary policy had played a significant role.
- Sizable groups selected the large amount of slack available when the expansion started (40%), moderate inflation (34%), tax rate reductions (31%), fiscal stimulus (27%), and absence of major imbalances (24%).
- Smaller numbers of respondents listed changes in the value of the dollar (16%), international factors such as synchronization of expansions (15%) or effective policy coordination (2%), and lower energy costs (10%).

So the message seems to be that favorable initial conditions, effective policy, and some luck have been the main contributors.

(Text continues on page 13.)

Chart 3

PROBABILITY OF RECESSION IN NEXT 12 MOS

(%, Median of Responses)

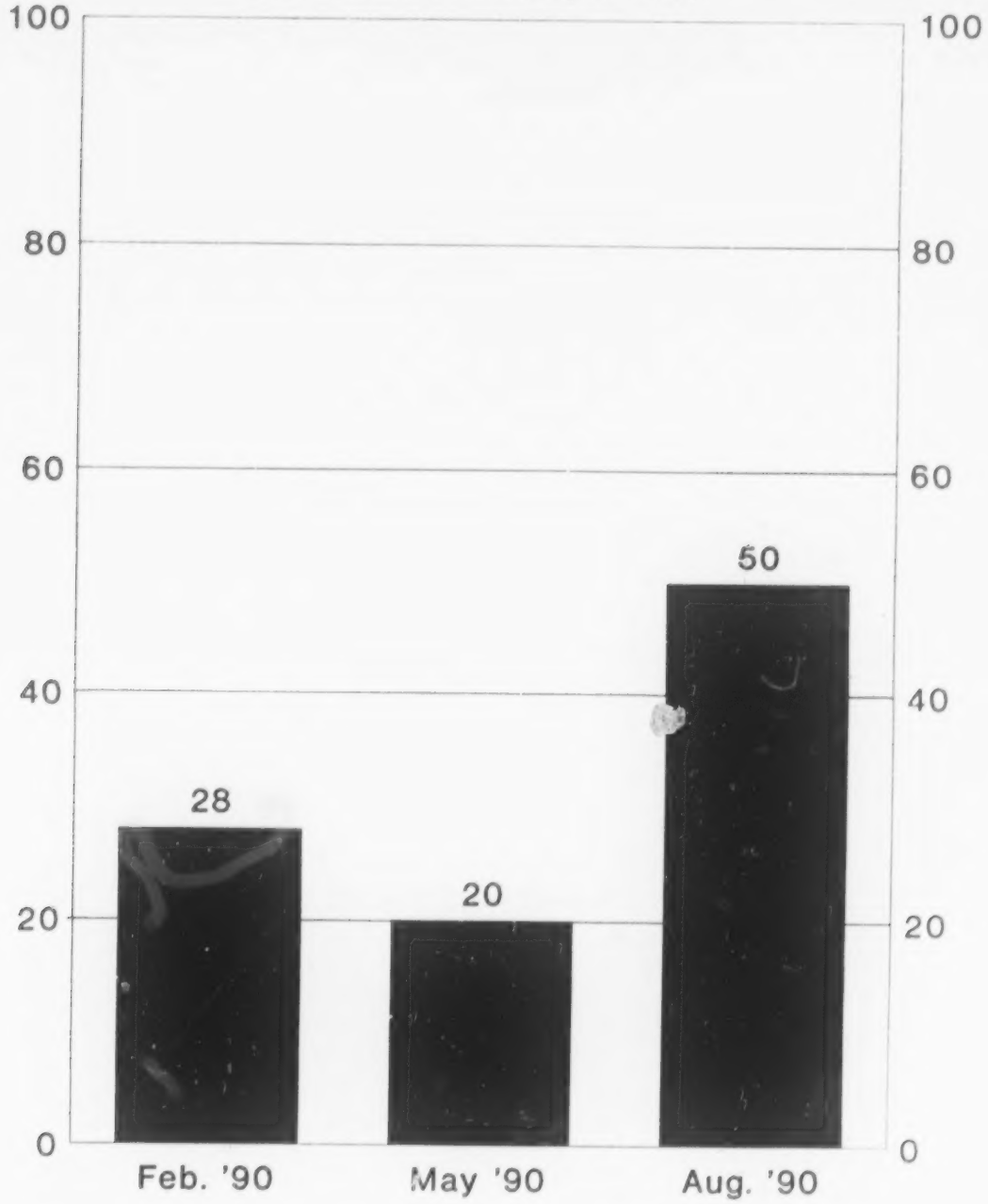
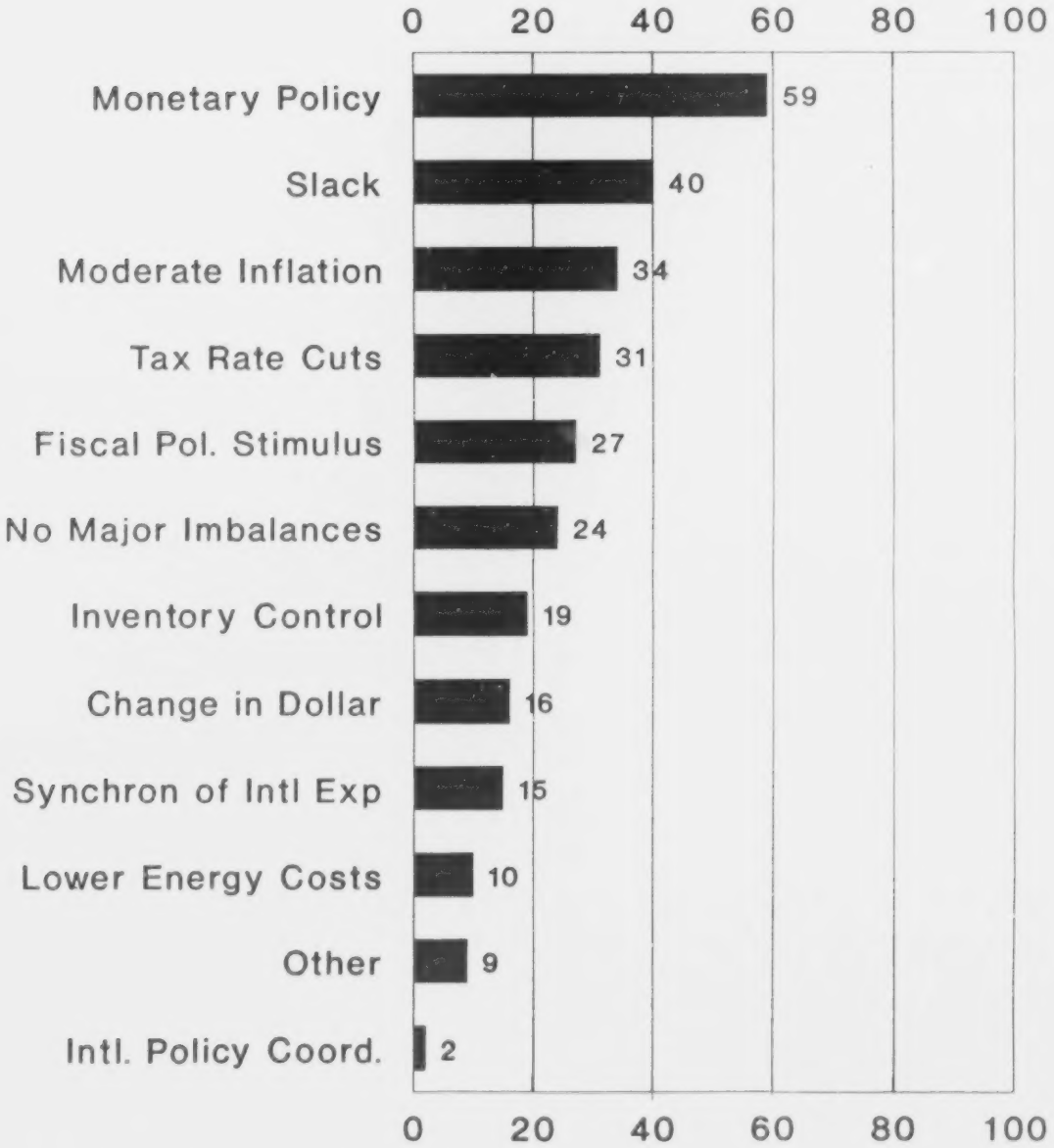


Chart 4

FACTORS BEHIND LONG EXPANSION *

(% of Respondents)

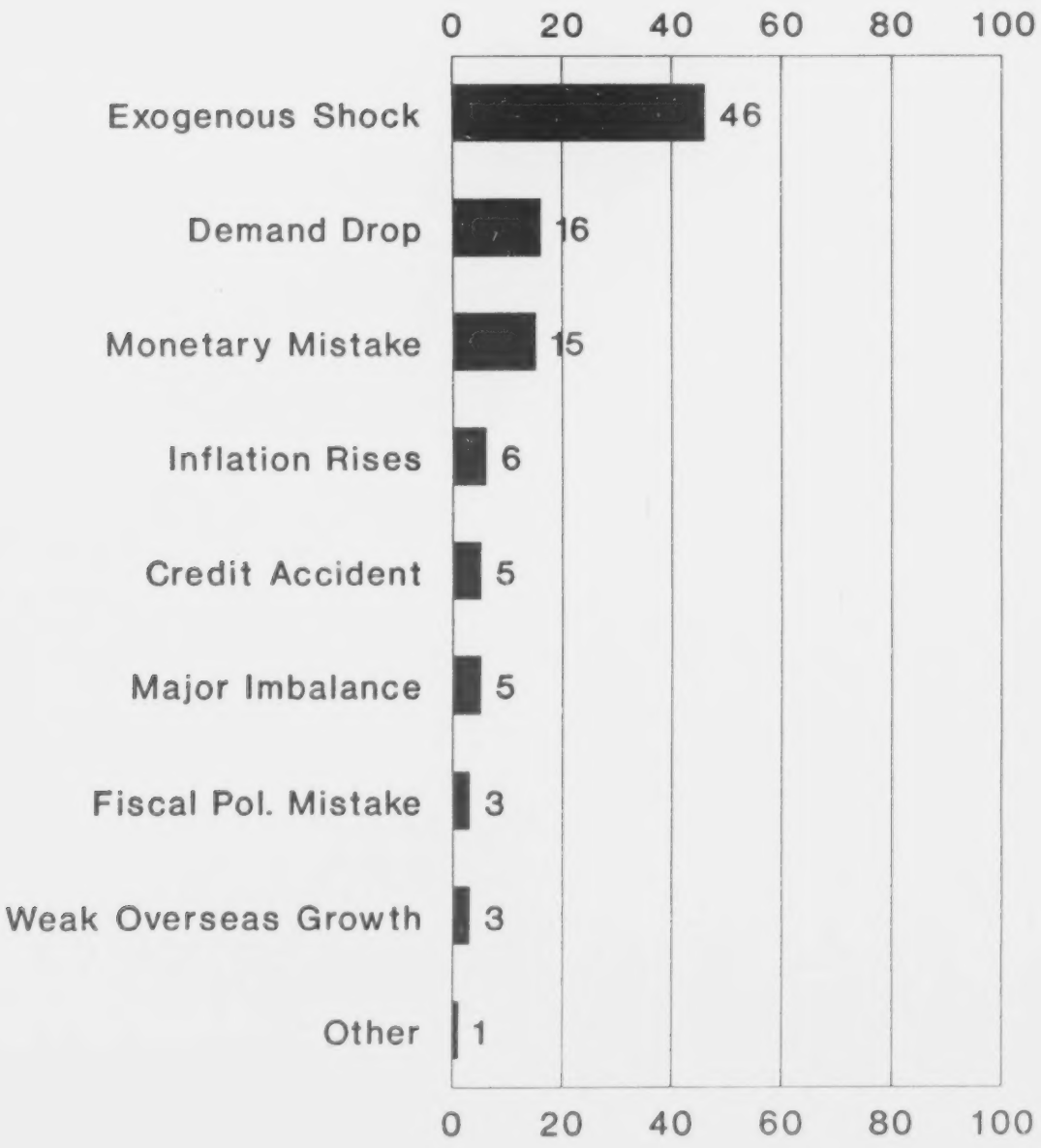


* Panelists chose 3 from above options

Chart 5

WHAT WILL CAUSE EXPANSION TO END?

(% of Respondents)



What might be the cause of a recession beginning in the next twelve months? We asked the forecasters to select only the primary culprit from a list of possibilities (see Chart 5). By far the largest number of respondents listed an exogenous shock or accident (46%) — not a surprise with the conflict in the Middle East and its impact on oil prices looming before us. Only two other options attracted 10% of the responses — i.e., an autonomous drop in demand (16%), which probably signifies that some of the forecasters had been detecting a worrisome slowdown in consumer spending, business investment and/or housing even prior to the August 2 invasion, and a mistake in monetary policy (15%). Interestingly, there was little support for the notions of a credit–induced accident (5%), a major imbalance developing in some sector (5%), overseas growth faltering (3%), or higher inflation/interest rates (6.0%) causing the expansion to terminate.

IMPACT OF PROSPECTIVE POLICY CHANGES AND EXTERNAL DEVELOPMENTS ON THE ECONOMIC FORECAST

A number of policy changes were in the works when the macroeconomic survey was taken, and the markets were just beginning to react to the Iraqi invasion of Kuwait. The forecasters were asked to tell us what sort of responses they would expect to these changes and how their forecasts would be affected.

Budget Action

The budget summit had stopped for the August recess when the survey was taken, but it was expected to reconvene in early September. No deal had been struck by the time the questionnaire had to be returned. One issue was what would happen to the risk of recession if a major multiyear budget deal emerged (approximately half in spending cuts and half in tax increases) and became effective at the beginning of fiscal 1991. We did not specify a whole series of other conditions such as what monetary policy would be followed (a point we will return to later). Almost half the panel think the risk of recession would rise (48%), and only a few conclude it would decrease (13%); the remainder (38%) believe the probability would be unchanged.

But when the question is put into a forecasting context with different responses from monetary policy, an important, different assessment emerges.

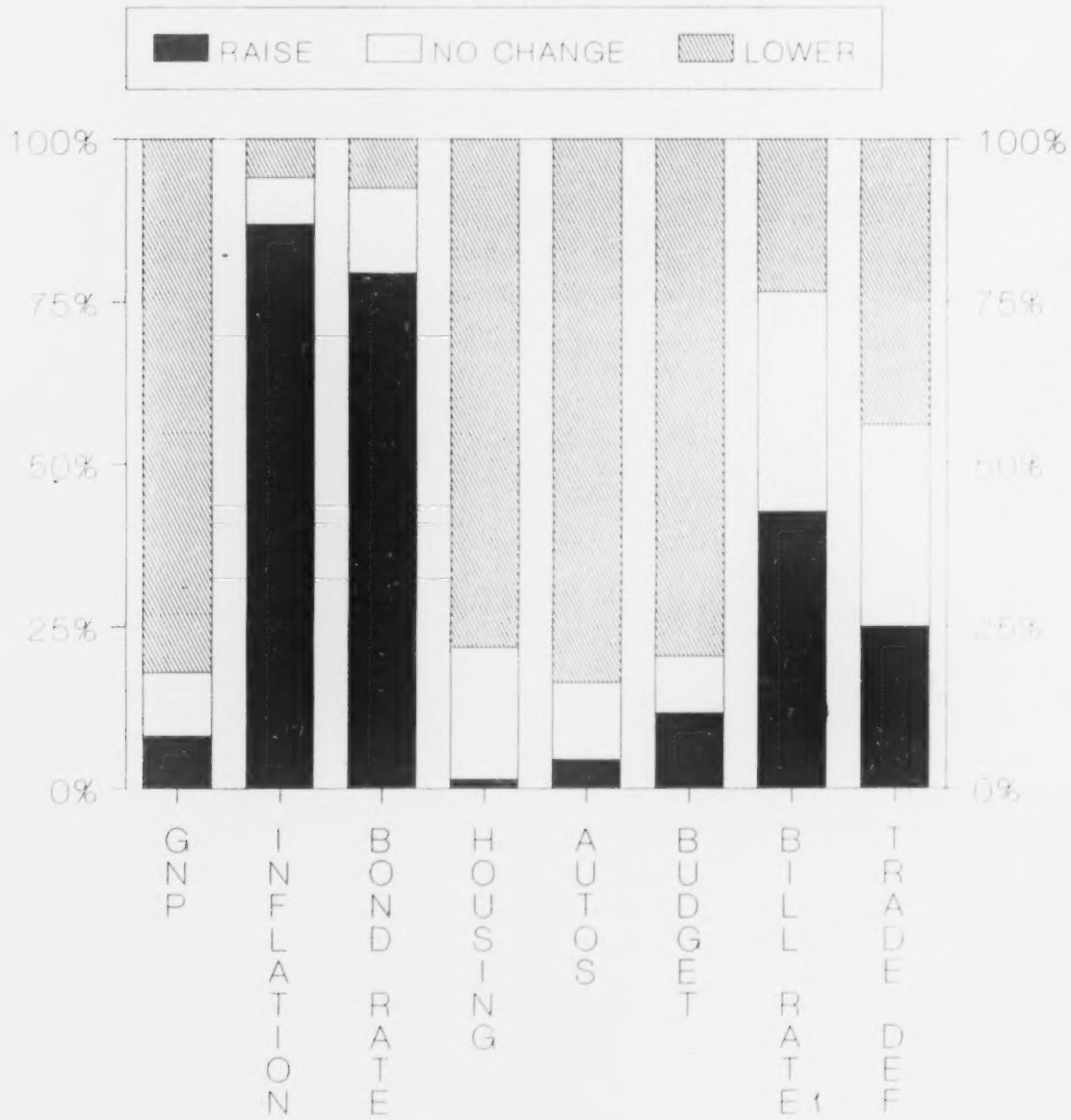
- If a major multiyear budget package were to be adopted (assuming no monetary policy changes, although interest rates are likely to fall as Alan Greenspan has suggested), here is how respondents would change their real GNP and inflation forecasts for the period 1990Q4–1991Q4:

	Real GNP	Inflation (CPI)
Raise	9%	17%
0.5% or more	0	0
Less than 0.5%	9	17
Lower	72	46
0.5% or more	19	14
Less than 0.5%	53	32
No change	19	38

Chart 6

IMPACT OF OIL PRICES ON FORECAST

(Changes for 1990Q4-1991Q4)



Most economists think that GNP growth will be reduced slightly and that inflation will be a bit lower or unchanged in this scenario.

- But if the budget agreement is accompanied by more accommodative monetary policy, the results change as follows:

	Real GNP	Inflation (CPI)
Raise	47%	45%
0.5% or more	8	9
Less than 0.5%	39	36
Lower	22	23
0.5% or more	0	5
Less than 0.5%	22	18
No change	31	32

With the easing of monetary policy, almost 80% of the panel conclude that real growth would be raised (47%) or not affected (31%) after a major budget package. Similarly, though, inflation would be either higher (45%) or unchanged (32%) since the economy does not weaken further and, presumably, because some of the tax changes raise prices (e.g., higher levies on alcohol, tobacco, or energy).

Impact of the Middle East Conflict

The economists were asked how their forecasts for the period 1990Q4–1991Q4 would be affected, compared with estimates made previously, by the Iraqi invasion and its probable effects upon oil prices. The responses are shown in Chart 6. Large majorities expect lower real GNP growth (87%), higher inflation (87%), higher 30–year Treasury Bond rates (79%), lower housing starts (78%), lower automobile sales (84%), and a worsening of the federal budget deficit (90%).

But there were two areas where opinion was quite divided: In the forecast of short–term interest rates (91–day Treasury Bills), 43% concluded they would be raised, while 34% saw no change and 24% predicted lower rates. Divergence in the impact of oil prices on growth versus inflation, along with the extent of "flight to liquidity" are the factors behind these conflicting assessments. In the case of the trade deficit, 44% think it will widen, 31% expect no change, and 25% contend there will be improvement. The trade–off here is between weaker GNP growth leading to lower import demand versus the higher cost of oil. The same issue arises in the revised forecast numbers presented earlier. The recent forecast revisions point toward sharp improvements in real net exports but only a modest adjustment in the estimate of the nominal trade balance.

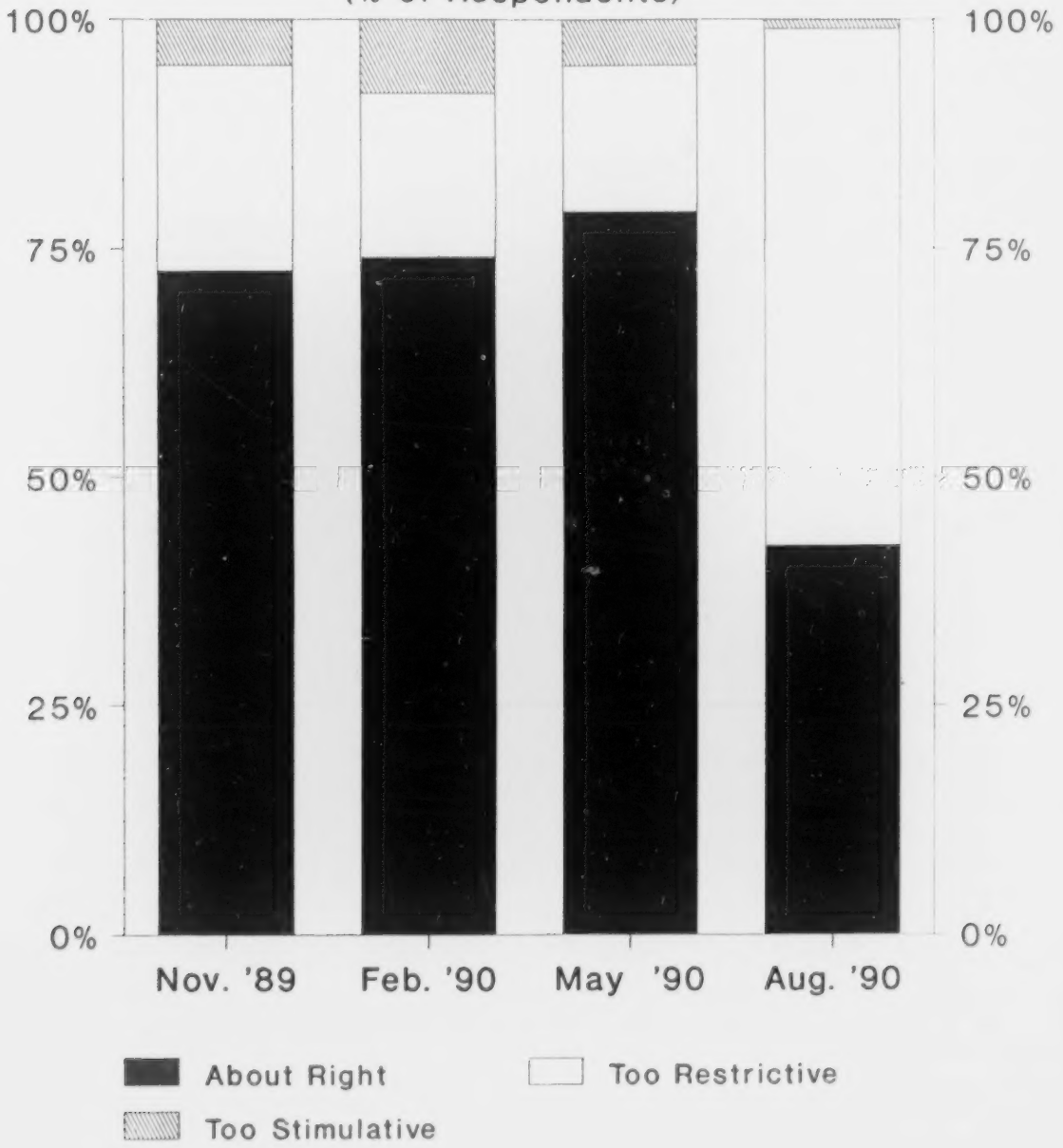
POLICY ASSESSMENTS

The NABE policy panel reviewed a number of subjects in its last survey, which was conducted in August. Some of the questions are directly related to the outlook issues discussed earlier — assessments of monetary policy, budget negotiations, and responses to economic problems presented by higher oil prices. Others concern longer–term matters such as energy policy, the GATT negotiations,

Chart 7

FEDERAL RESERVE POLICY ASSESMENT

(% of Respondents)



and deposit insurance. The answers are based upon 242 replies, which is about the usual response total for this survey.

Monetary Policy

There was a dramatic shift in the policy group's collective view of monetary policy (see Chart 7). Usually a sizable majority of the panel (often 70–80%) indicate that monetary policy is "about right," and that has been our conclusion up through the prior inquiry (i.e., the one taken in late May and published in July). But in the latest edition, only 42% checked "about right"' while 56% evaluated the current stance as too restrictive. The Federal Reserve's most recent move, a 25–basis–point reduction in the Federal funds rate in mid–July, was well known to the panel before the questionnaire went out.

In light of this conclusion, it is not surprising that 68% of the economists anticipate the Fed will adopt easier policy in the six months ahead; 28% anticipate a neutral stance, and only 4% look for tightening. The breakdown is as follows:

WHAT WILL THE FED DO IN THE NEXT SIX MONTHS?

Action	Percent of Respondents
Tighten	4%
Raise discount rate	1
Tighten reserves, raise market rates	3
Stay neutral	28
Ease	68
Ease reserves, lower market rates	53
Lower discount rate	15
	100%

According to the panel the Fed will be most influenced in its policy deliberations and moves by the pace of economic growth (according to 55%), rather than by inflation/inflationary expectations (30%) or anything else (15%). In the previous survey the responses were more evenly divided, but inflation drew the most (48), while the growth rate was a little behind (42%) and other considerations attracted little support (10%).

Budget Issues

Assessing the budget outlook in its various dimensions occupied much of the policy panel's attention over the last year. Whenever we have asked for some sense of the urgency to change fiscal policy, the panel always attached considerable importance to actions to reduce the federal deficit significantly and steadily over the next several years. But NABE economists have been skeptical about reaching a major, multiyear package during the current round of negotiations. In the August inquiry, for example, only 37% of respondents thought a multiyear deal would be struck, and only 18% thought the first year (and subsequent installments) would exceed $15 billion in real spending reductions and/or tax increases. The rest thought either that there would be a one–year deal only (primarily cosmetic) or that negotiations would fail, with a probable repeal or suspension of the Gramm–Rudman–Hollings targets. (As this analysis is being prepared, there have been some hopeful comments from the summiteers, but no agreement has been announced.)

If a major budget package were to be achieved, the policy assessors believe by an overwhelming margin that alcohol (94%) and tobacco (94%) taxes will be raised. Only 30–40% of the group list the following taxes as part of the package: gasoline, personal tax rates, and capital gains. On the spending side, a majority indicate that major cuts in defense (55%) and nondefense/discretionary (52%) outlays will be made, but much smaller portions think major savings will be achieved in means–tested entitlements (17%) or non–means–tested entitlements (22%). Indeed, these responses reveal the dilemma we explored in several earlier policy surveys: The panel can identify a number of places where economically sensible deficit–reducing actions can be taken, but in many of these instances the political obstacles remain severe.

Policy Responses in Light of the Middle East Conflict

The higher oil prices and greater uncertainty brought about by the Iraqi invasion create new problems for policy–makers. The economists were asked for both their advice and their predictions of what will happen:

- First, on monetary policy the panel is equally split on whether the Federal Reserve should keep its prior strategy or ease, but there is little sentiment for tightening. The division is about the same on what the Fed will do. These responses can be reconciled with the earlier tabulation, in which 68% expect ease over the next six months, by the prospect that following the prior strategy would be thought by many analysts to call for ease.

IN LIGHT OF MIDDLE EAST CONFLICT, THE FED SHOULD/WILL CHANGE TO:
(% of Respondents)

Action	Recommendation	Prediction*
No change in strategy	47%	44%
Tighten	6	13
Ease	47	44
Total	100%	100%

* Components do not sum to 100 due to rounding error.

- On the issue of whether there should be any fiscal adjustment, the consensus is not to alter direction but to seek a smaller package. 86% of the economists advise the negotiators to seek either the same–size, multiyear deficit reduction (32%) or a smaller amount in 1991 and more in later years (54%). Members of the panel expect negotiators to aim for a smaller initial amount and more thereafter (75%).

IN LIGHT OF MIDDLE EAST CONFLICT, THE BUDGET NEGOTIATORS SHOULD/WILL CHANGE TO:
(% of Respondents)

Action	Recommendation	Prediction*
Seek same package	32%	6%
Seek smaller deficit reduction	54	76
Seek larger deficit reduction	11	3
Abandon efforts to agree	4	17
Total	100%	100%

* Components do not sum to 100 due to rounding error.

- Should the Fed behave differently if a major budget package accompanies the oil price shock that the turmoil in the Gulf has brought? Most economists (64%) advise an easing of monetary policy. A slightly smaller majority (58%) believe that is what the Fed will do, although 33% think the prior strategy will remain in place. There is, of course, an ambiguity here in that, with a weak economy already, the Fed could well ease and still follow the old strategy.

IF A MAJOR BUGET DEAL ACCOMPANIES HIGHER OIL PRICES, WHAT SHOULD/WILL FED DO?
(% of Respondents)

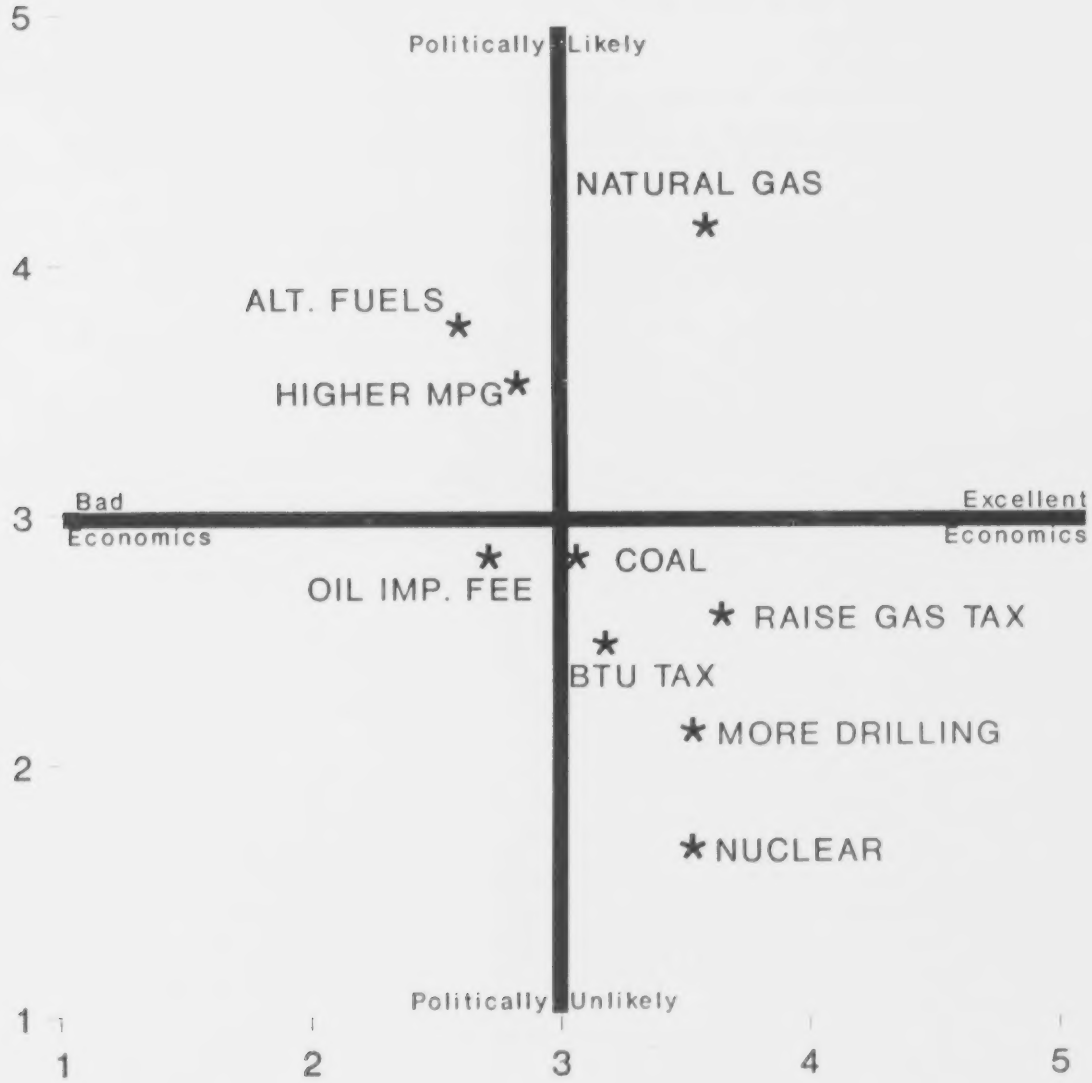
Action	Recommendation	Prediction
No change in strategy	30%	33%
Tighten	6	9
Ease	64	58
Total	100%	100%

Energy Policy

Inevitably, the surge in oil prices and the threat to supply will lead to a reconsideration of energy policy in the United States. When asked about whether policy should be changed, the NABE economists are interventionist: Only 23% advise no change and continuing reliance on market prices alone. 77% would either adopt measures to encourage development of new supply (5%) or encourage conservation (12%) or do both (60%). The policy panel assessed the economic merit and political feasibility of a number of options. Chart 8 presents the results. (Each option is evaluated on both dimensions using a scale of 1 = lowest, 3 = neutral, and 5 = highest.) Almost all of the alternatives are scored above the neutral reading on economic merit, with the exceptions of the development of alternate fuels (e.g., methanol, ethanol), the imposition of an oil import fee, and the imposition of higher fuel–efficiency standards upon automobile producers. The bigger problem is low political feasibilityscores on many options. Only one had above–neutral scores on both counts using medians of the ratings.

Chart 8

U.S ENERGY POLICY ALTERNATIVES: ECONOMIC VS POLITICS



Energy Policy Option	Economic Merit	Political Feasibility
Encourage use of natural gas	3.76	4.02
But several options come very close:		
Encourage use of coal	3.03	2.83
Encourage development of alternative fuels	2.88	3.43
Impose mileage standards for auto producers	2.95	3.35

GATT Negotiations

A number of central issues continue to frustrate trade negotiators as they struggle to complete the Uruguay round by the end of 1990. Members of the policy panel assessed the competitive importance to the United States of several of these issues, and then they looked at the prospects for successful resolution. (The same 1 = lowest, 3 = neutral, 5 = highest scale was used.) The conclusion is quite pessimistic: The stubborn items have considerable importance to the United States, and it is unlikely that they can be fully resolved. The median response is shown below. (See the tables and charts at the end of this report for additional policy survey results.)

GATT Issue	Competitive Importance	Likelihood of Successful Resolution
Reduce internal agricultural subsidies	4.08	2.01
Reduce agricultural export subsidies	4.01	2.26
Reduce import protection on farm products (e.g. health–related reguations)	3.82	2.38
Reduce foreign tarriffs and quotas	4.16	2.86
Guarantee right of U.S. firms to enter business to provide services	3.73	2.80
Protect U.S. intellectual property rights	4.03	2.96

NABE LONG–RUN OUTLOOK

Once each year we ask the macro forecast panel for their assessment of the five–year outlook for several key economic magnitudes. The results of these surveys, along with the actual data, are provided in a table at the end of this report.

The more interesting feature of these estimates, however, is how economists assess the changing long–run parameters for the U.S. economy. We began asking these questions in the mid–1970's, and, with a few interruptions, the results show deceleration in both real growth and inflation.

Chart 9
NABE LONG RUN FORECASTS OF REAL GNP AND PRODUCTIVITY

(% Chg., Median, next 5 years)

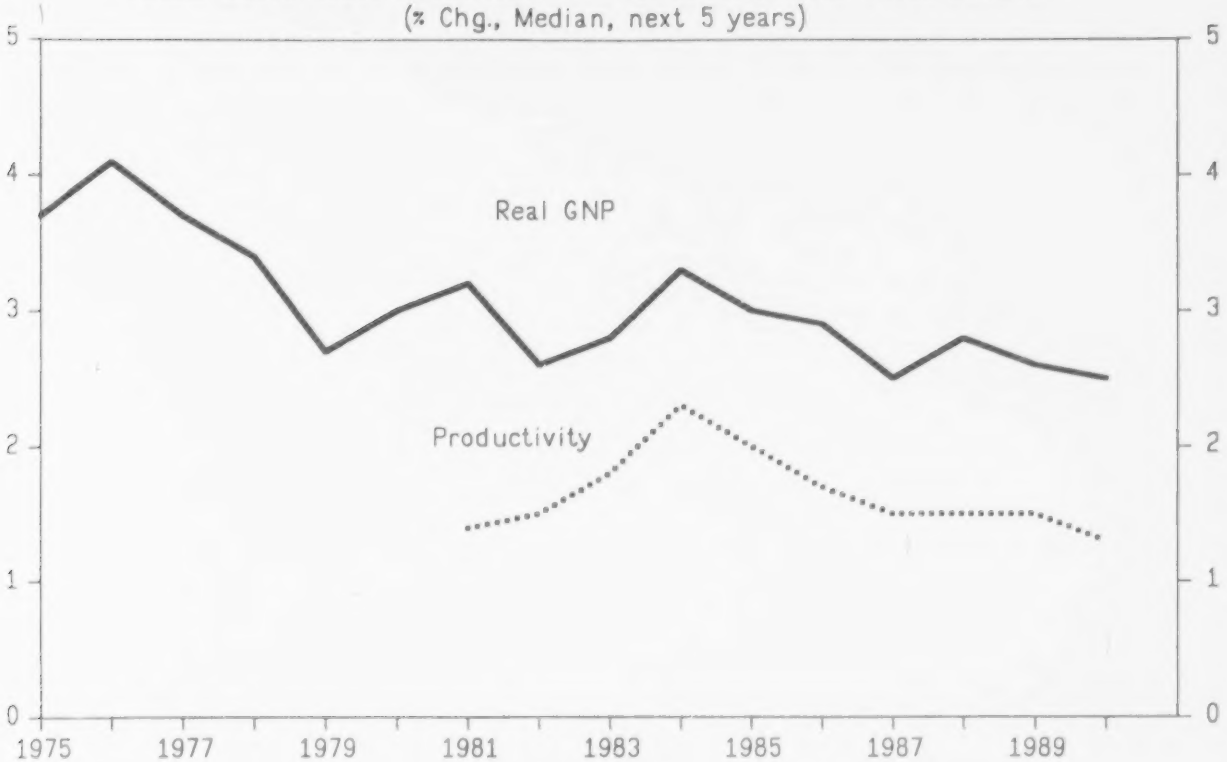
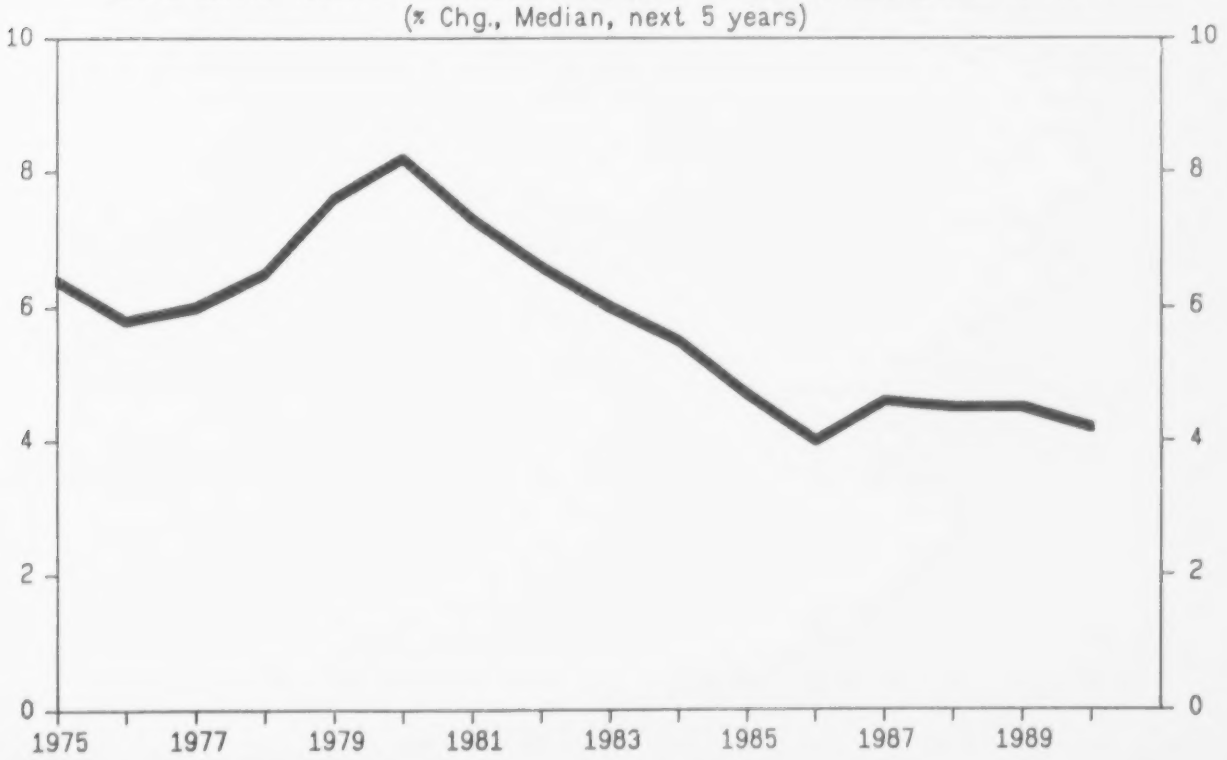


Chart 10
NABE LONG RUN INFLATION FORECAST – CONSUMER PRICE INDEX

(% Chg., Median, next 5 years)



Real GNP and Productivity

As Chart 9 reveals, NABE forecasters assessed the long–term growth prospects for real GNP in the 3.5–4.0% per annum range in the mid– to late 1970's. Since then, however, there has been a gradual, albeit erratic, lowering of the estimated five–year growth trend to about 2.5% at present. Part of the reason for the slowdown is demographics — i.e., the well–documented slowdown in prospective labor force growth. Another part is slow productivity growth. NABE did not start asking for five–year productivity estimates until the late 1970's, but, as is also shown in Chart 9, economists expect productivity to grow at 1.3% per year. This estimate is about the same as what we found in the early 1980's, but it is down from more optimistic assessments around the middle of the decade.

Slow productivity gains and deceleration in the long–run pace of real GNP advance make it difficult to raise standards of living, to offset wage pressures, and to channel resources toward pressing national problems. At the same time, though, there is a small positive twist that can be put on these forecasts: There has been some recent worry that the long–run growth rate for real GNP might be as low as 1–2%. The evidence cited for this position is that, over the period 1989Q2–1990Q2, the unemployment rate remained very stable near 5.3% — which some would regard as about full employment. Meanwhile, real GNP grew at only a 1.3% annual rate over the same interval. Perhaps, then, the trend growth of the economy is about that rate. But NABE economists reject the proposition that the growth trend is in the 1–2% range. Our latest survey continues to show five–year growth to be higher — i.e., 2.5% per annum.

Inflation

The five–year inflation outlook has been improving according to the NABE panel; the survey results are in Chart 10. In the mid–1970's the five–year rate was projected to be in the 6–7% range, and in the early 1980's even higher rates were projected (i.e., 7–8%). But over the last decade, forecasters have lowered their long–run inflation projections, so we now look for the trend in the CPI to be about 4.2%. Such a pace remains well above the goal of the Federal Reserve, but the movement over the last decade has been in the right direction.

These expected inflation rates can be used to estimate real interest rates. Chart 11 shows the nominal rate on ten–year government bonds less the five–year expected inflation rate from the NABE long–run survey. Over the last fifteen years, the real interest rate rose markedly. Since the mid–1980's, however, the real rate has fallen into the 4.0–4.5% range, with a slight upward drift in the last few years.

Trade–Weighted Dollar

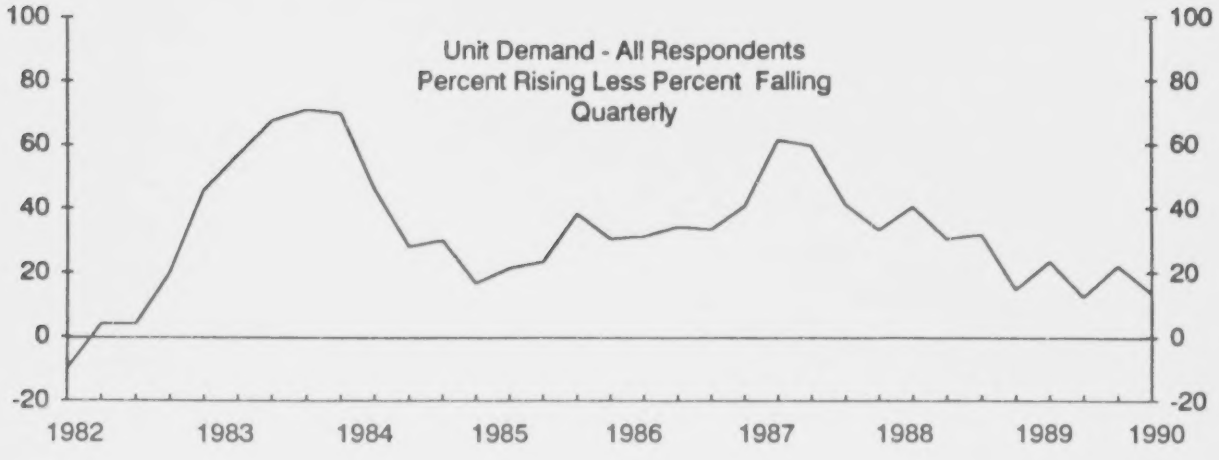
In the last several annual surveys, we have asked the panel to assess the outlook for the trade–weighted value of the dollar over the next five years. In the current edition, 51% expect the dollar to decline by 5% or more, with most opting for a range of –5% to –15%. Another 19% expect little change — i.e., a range of +5% to –5% — while 30% expect the dollar to appreciate by 5% or more.

Chart 11
REAL INTEREST RATE IMPLIED FROM NABE INFLATION FORECAST *

(Nominal 10 year T-Bond yield less expected inflation over next 5 years

* 1990 point is average for June, July and August.

Chart 12
INDICATORS FROM NABE INDUSTRY SURVEY
July 1990



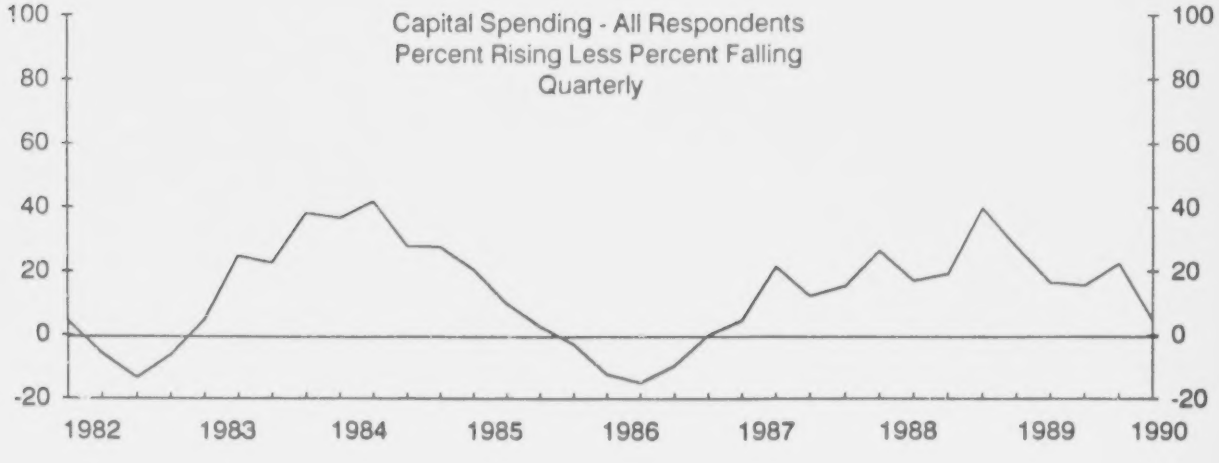


Table 2
HISTORICAL TRACK RECORD FOR NABE FORECASTS
(Forecasts made the previous summer)

	Real GNP Growth			CPI-U*		
	Forecast	Actual	Difference	Forecast	Actual	Difference
1977	5.1	4.7	0.4	6.0	6.7	-0.7
1977	4.5	5.3	-0.8	6.2	7.3	-1.1
1977	2.5	2.5	0.0	7.3	8.9	-1.6
1980	0.1	-0.2	0.3	7.8	9.1	-1.3
1981	0.7	1.9	-1.2	8.9	9.6	-0.7
1982	3.0	-2.5	5.5	8.3	6.4	1.9
1983	2.9	3.6	-0.7	6.5	3.2	3.3
1984	4.5	6.8	-2.3	5.0	4.3	0.7
1985	3.6	3.4	0.2	5.0	3.6	1.4
1986	2.8	2.7	0.1	4.1	1.9	2.2
1987	2.7	3.4	-0.7	3.3	3.7	-0.4
1988	2.7	4.5	-1.8	4.7	4.1	0.6
1989	2.0	2.5	-0.5	5.1	4.8	0.3
1990	1.8	1.2 (est.)	0.6	4.5	5.3 (est.)	0.8
1991	1.2			5.3		
Average Absolute Error			1.1			1.2

* GNP Deflator for 1975-81;CPI All-Urban Consumers 1982-1990

Table 3
NABE MEDIAN LONG-RUN FORECASTS
HISTORICAL RECORD

Year of Forecast	For Five-Year Period Ending In:	Real GNP Growth Rates (%) Projected	Real GNP Growth Rates (%) Actual	Inflation Rates (%) * Projected	Inflation Rates (%) * Actual	Productivity Growth Rates Projected	Productivity Growth Rates Actual
1975	1979	3.7	3.2	6.4	7.8	---	---
76	80	4.1	3.4	5.8	7.6	---	---
77	81	3.7	2.8	6.0	8.3	---	---
78	82	3.4	1.4	6.5	8.3	---	---
79	83	2.7	1.0	7.6	7.5	1.2	0.2
80	84	3.0	1.9	8.2	6.5	N/A	0.9
81	85	3.2	2.6	7.3	5.3	1.4	1.3
82	86	2.6	2.7	6.6	3.8	1.5	1.5
83	87	2.8	4.0	6.0	3.3	1.8	1.9
84	88	3.3	4.1	5.5	3.5	2.3	1.7
85	89	3.0	3.3	4.7	3.6	2.0	1.6
86	90	2.9	2.9 (est)	4.0	4.0(est)	1.7	0.8(est)
87	91	2.5		4.6		1.5	
88	92	2.8		4.5		1.5	
89	93	2.6		4.5		1.5	
90	94	2.5		4.2		1.3	

* GNP Deflator for 1975-81; CPI-All Urban Consumers for 1982-1990

ADDITIONAL QUESTIONS FROM THE AUGUST 1990 POLICY SURVEY

IN YOUR OPINION, WHAT IS THE BEST PROCESS TO ALLEVIATE TRADE RESTRAINTS?

	Percent of Respondents
a) Negotiations through GATT	6%
b) Multilateral negotiations, but an overhaul of GATT is needed	18
c) Bilateral talks introducing free-trade pacts (e.g., Canada, Mexico)	20
d) Unilateral actions such as Super 301 provisions	2
e) All channels of action (multilateral, bilateral, unilateral)	44
f) A combination of multilateral and unilateral negotiations	9
g) None of the above	1

WHAT DO YOU BELIEVE WILL BE THE OUTCOME OF THE URUGUAY ROUND OF GATT NEGOTIATIONS?

	Percent of Respondents
a) A major trade agreement that will lower worldwide barriers to trade	12%
b) A cosmetic trade agreement that will claim to lower trade barriers, but in reality will only provide a patchwork solution to the trade problems	84
c) A complete failure in reducing trade barriers that will force the U.S. to rely upon unilateral policy action	4
d) Other	1

WHAT ROLE DO YOU BELIEVE DEPOSIT INSURANCE PLAYED IN THE SAVINGS AND LOAN FAILURES?

	Percent of Respondents
a) The primary role	10%
b) A major role, but in the end did not itself cause the collapse of the thrifts	52
c) A minor role that only exacerbated other problems in the industry	35
d) No role	3

IN LIGHT OF YOUR ANSWER TO THE PRIOR QUESTION, DO YOU BELIEVE AN OVERHAUL OF THE DEPOSIT INSURANCE SYSTEM IS IN ORDER?

	Percent of Respondents
a) Yes	76%
b) No	24

ON A SCALE OF 1 TO 5 (1=LOWEST, 3=NEUTRAL, 5=HIGHEST) FOR ECONOMIC MERIT AND POLITICAL FEASIBILITY, PLEASE RANK THE FOLLOWING PROPOSALS TO REFORM DEPOSIT INSURANCE:

	Economic Merit	Political Feasibility
a) Reduce deposit ceiling	3.4	2.5
b) Limit depositors to one insured account	3.3	2.9
c) Link premiums banks pay for insurance to the riskiness of their assets	4.4	3.4
d) Set up "firewalls" to revent deposit insurance from covering newly deregulated products	3.3	3.4
e) "Haircut" reimbursement above a certain limit	2.9	3.0
f) Eliminate deposit insurance	1.8	1.1

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